Budget Plan

Tabled in the House of Commons
by the Honourable Paul Martin, P.C., M.P.
Minister of Finance

February 27, 1995

Canada

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Including Supplementary Information and Notices of Ways and Means Motions

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Department of Finance Canada
Ministère des Finances Canada

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Introduction and overview

The 1995 budget is the second in a two-stage process, initiated with last year's budget, to sustain growth and create jobs by addressing the long-term deterioration of the financial condition of the Government of Canada. The 1994 budget proposed measures to reduce the federal deficit towards the interim target of 3 per cent of GDP by 1996-97, *en route* to the ultimate goal of a balanced budget. It stressed that while reduced government expenditure was necessary, cuts could not be the only element of a strategy to promote economic growth and job creation. Significant reform of the way government operates was also essential.

A number of reviews were launched with the 1994 budget to provide the necessary background and to frame the consultations that would lead to decisions on reform. The government also committed to provide a mid-year update on the economic and fiscal situation and the implications for achieving the deficit targets. The *Economic and Fiscal Update*[1], released on October 18, showed that owing to higher-than-anticipated interest rates, greater fiscal action would be required to achieve the deficit targets in 1995-96 and 1996-97.

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[1] *Agenda: Jobs and Growth, Creating a Healthy Fiscal Climate: Economic and Fiscal Update*, Government of Canada, October 1994.

The release of the Update and its companion piece, *A New Framework for Economic Policy*[2], initiated widespread consultations on the economic and fiscal challenges facing Canada. The Finance Committee of the House of Commons held hearings across the country and made recommendations to Parliament on December 5. More than ever before, Canadians engaged in discussions about the nation's fiscal future – with the Finance Committee, in meetings with the Minister of Finance across the country, through letters to Members of Parliament, by participating in discussions sponsored by the Canadian Foundation for Economic Education, and in general discussion.

This widespread involvement in the fiscal dialogue demonstrates that the fiscal problems of this country go beyond the concern of investors and money markets. The issues affect the well-being of all Canadians.

The Finance Committee's report to Parliament recommended that far-reaching action be taken to turn the tide of fiscal deterioration. The vast majority of Canadians who expressed their views agreed. While recognizing that this would involve significant change, the alternative was seen as unacceptable – an unsustainable accumulation of debt, a lower standard of living and the loss of our ability to determine Canada's future.

The government agrees and will act accordingly to restore the nation's fiscal health.

Policy Actions

This budget will fundamentally reform what the federal government does and how it does it. The objective is to get government right

This budget will fundamentally reform what the federal government does and how it does it. That reform is *structural* – i.e. it will change permanently the way government operates. The objective is to *get government right* so that it can fulfil its social and economic mandates more effectively and sustainably. This will include deep cuts in the *level* of federal program spending – not simply lower spending *growth*, but a substantial reduction in actual dollars spent.

This budget secures those savings and confirms the structural changes that will ensure permanent fiscal health.

[2] *Agenda: Jobs and Growth, A New Framework for Economic Policy*, Government of Canada, October 1994.

In the past, departmental budgets have often been reduced without fundamental review or change in mandate or manner of delivering public services. This often resulted in continued application of resources to lower-priority activities and a progressive loss in the capability of doing a good job on core responsibilities.

This budget adopts a different course. Mandates for the government as a whole and each department have been examined and changed to bring them into line with modern realities, including the need for fiscal restraint. Lower priority programs have been eliminated or sharply cut back. Program delivery mechanisms have been made more efficient.

As such, the changes to program spending are structural rather than transitory.

Among the highlights of the actions described in detail in Chapters 4 and 6 are:

- the budget implements the results of Program Review – a comprehensive examination of federal departmental spending. That review will cause the government to focus on what is essential, and to do it better. Three years from now, spending by federal government departments will be $9½ billion lower than it is today;
- major changes in transfers to the provinces will renew and modernize the federal-provincial fiscal regime, making it more effective, flexible and affordable; and
- the budget sets the fiscal parameters within which labour market programs will be re-designed to foster increased employability.

Tax measures play a small role in this budget. Personal income tax rates are not being increased. Some tax measures are being taken, however, to ensure that all taxpayers pay what is owing. Other measures will increase fairness. Finally, a small number of corporate and excise tax increases are proposed to complement much greater action on program spending.

Tax measures play a small role in this budget

Implications of Budget Actions

Deficit targets will be met

This budget demonstrates the government's commitment to restore Canada's fiscal health:

- the deficit target of $39.7 billion for 1994-95, set out in last year's budget, will be met. In fact, apart from certain one-time restructuring charges, the underlying deficit for 1994-95 is projected to be $4.4 billion below the target;
- the deficit targets of $32.7 billion in 1995-96 and 3 per cent of GDP in 1996-97 will be achieved (Table 1.1);

Table 1.1
Summary statement of transactions:
Fiscal outlook with budget measures

	1993-94	1994-95	1995-96	1996-97
	(billions of dollars)			
Budgetary transactions				
Budgetary revenues	116.0	125.0	133.2	137.4
Program spending	-120.0	-118.3	-114.0	-107.9
Operating balance	-4.0	6.7	19.2	29.4
Public debt charges	-38.0	-42.0	-49.5	-50.7
Underlying deficit	-42.0	-35.3	-30.2	-21.3
Restructuring charges		-2.6		
Contingency reserve			-2.5	-3.0
Deficit	-42.0	-37.9	-32.7	-24.3
Non-budgetary transactions	12.2	11.9	7.8	10.6
Financial requirements (excl. foreign exchange transactions)	-29.8	-26.0	-24.9	-13.7
Net public debt	508.2	546.1	578.8	603.1
Gross domestic product	711.7	746.4	787.1	821.3
Percentage of GDP				
Budgetary revenues	16.3	16.7	16.9	16.7
Program spending[1]	16.9	16.2	14.5	13.1
Public debt charges	5.3	5.6	6.3	6.2
Deficit	-5.9	-5.1	-4.2	-3.0
Financial requirements	-4.2	-3.5	-3.2	-1.7
Net public debt	71.4	73.2	73.5	73.4

[1] Includes restructuring charges.

Notes: (-) indicates a net requirement for funds.
(+) indicates a source of funds.

Numbers may not add due to rounding.

- the economic projections underlying these deficit forecasts are prudent. The actual outcome may well be better even if economic conditions turn out to be as assumed, in which case the contingency reserves included in the fiscal projections may not be needed. Should conditions turn out to be more favourable than assumed, the deficit will be even lower than the underlying deficit shown in Table 1.1;
- the significant reforms proposed here ensure that spending will be restrained beyond 1996-97. The deficit will continue to fall;
- fiscal actions announced in this budget will reduce the deficit by $5.0 billion in 1995-96, $10.6 billion in 1996-97 and $13.3 billion in 1997-98. The cumulative direct impact of these savings is $29.0 billion over the next three years. This means that the net debt in three years will be $29.0 billion lower than it otherwise would have been. This is by far the largest set of actions in any Canadian budget since post-war demobilization. The savings come primarily from $25.3 billion of cumulative spending reductions – nearly seven dollars of spending reduction for every dollar of tax revenue increase (Table 1.2);

The deficit will continue to fall beyond 1996-97

Table 1.2
Total direct impact of budget measures

	1995-96	1996-97	1997-98	3-year impact
		(billions of dollars)		
Expenditure reductions				
Program review	3.9	5.9	7.2	16.9
Other	0.2	3.5	4.7	8.4
Total	4.1	9.3	11.9	25.3
Tax measures				
Increase fairness and tighten tax system	0.1	0.4	0.6	1.1
Tax increases	0.9	0.9	0.8	2.6
Total	0.9	1.3	1.4	3.7
Total direct impact of fiscal actions	5.0	10.6	13.3	29.0
Ratio of expenditure reductions/ tax revenue increases	4.4:1	7.3:1	8.3:1	6.9:1

[1] Three-year cumulative impact of deficit reductions shows the direct reduction in net debt, by the end of the 1997-98 fiscal year, arising from fiscal actions. Restructuring charges of $2.6 billion in 1994-95 are not included. These costs will be offset over the three-year period by lower interest costs associated with actions announced in this budget.

Numbers may not add due to rounding.

Program spending is projected to decline

■ by 1996-97, total program spending will be $10.4 billion or 8.8 per cent lower than in 1994-95 (excluding 1994-95 restructuring costs). As a percentage of GDP, program spending (excluding restructuring costs) is projected to decline from 15.8 per cent in 1994-95 to 13.1 per cent in 1996-97. This is the lowest such level since 1950-51 and down from a peak of 19.6 per cent in the mid-1980s;

■ excluding major transfers to persons and the provinces, program spending will decline even more sharply, falling by nearly 19 per cent between 1994-95 and 1997-98.

Outline of the Budget Plan

Chapter 2 describes recent international and Canadian economic developments and establishes the planning assumptions that underlie the fiscal projections. These assumptions have deliberately been chosen to be prudent relative to the average of private sector outlooks.

Chapter 3 describes recent trends in federal government revenue and expenditure, and sets out the implications of the economic planning assumptions for the deficit in the absence of further fiscal actions.

Chapter 4 describes the measures being taken in this budget to meet the deficit targets in 1995-96 and 1996-97, and to lay the foundation for continuing fiscal improvement in 1997-98 and beyond.

Chapter 5 summarizes the implications of the budget actions for the fiscal outlook, demonstrating that the government will achieve its fiscal targets, on track and on time and set a course for ongoing progress.

Chapter 6 provides details of a comprehensive review of departmental programs that was undertaken over the past year. As a result of the Program Review, lower-priority activities will be cut sharply or eliminated, freeing government resources to provide the services that Canadians most want, that the federal government can best deliver, and that the country can afford.

Annex 1 describes the government's follow-up to the Review of Forecasting Accuracy and Methods, a study commissioned from a private sector consulting firm to review Finance's forecasting record and make recommendations for improvement. Annex 2 shows how actions, both in this budget and already underway, respond to the *Report of the Auditor General of Canada, 1994*. Annex 3 sets out the government's response to the *Task Force on Economic Instruments*. Annex 4 compares Canada's fiscal situation with that of the United States. Annex 5 describes the compliance of the government with the *Spending Control Act*, and Annex 6 provides supplementary information on tax measures contained in this budget.

2

The economic assumptions

Prudent budget planning begins with prudent economic assumptions. These assumptions drive the fiscal forecast, which in turn determines the amount of budget action needed to achieve deficit targets.

In the past, assumptions that were often too optimistic led to budget measures that were inadequate. Fiscal targets were often missed and credibility was damaged (Annex 1). This government is committed to a more responsible approach to fiscal planning, using prudent economic assumptions and taking sufficient fiscal action to ensure that the deficit targets will be met.

Prudent economic assumptions will ensure deficit targets are met

Developing the Economic Assumptions

The government has consulted extensively as to the appropriate economic assumptions on which to base the budget. This began with the release of the *Economic and Fiscal Update* last October, which presented three economic scenarios. The first was based on the average of private sector views on growth, inflation and interest rates. The second retained the private sector average outlook for real growth and inflation but assumed interest rates would be one-half percentage point higher. The third economic scenario was based on interest rates that were one percentage point higher than the private sector average, implying that both real growth and inflation would be lower than the private sector average.

The House of Commons Standing Committee on Finance was asked, among other things, to comment on the economic and fiscal assumptions presented in the October Update. The Committee recommended use of interest rate assumptions equal to the private sector average plus a "prudence factor" of between one-half and one percentage point.

The economic outlook has changed considerably since then. In particular, interest rates are now much higher than expected by private sector forecasters last September and higher than in the least favourable scenario in the October Update. There is also now greater risk that the U.S. economy will slow sharply within the next year or so, as interest rates are pushed up to contain inflation pressures. Canadian and U.S. interest rate forecasts for this year and next have thus been revised up substantially by private sector forecasters, and real growth projections have been revised down for 1996.

The economic assumptions underlying this budget reflect the views of Canadians

The economic assumptions underlying this budget have taken into consideration the views of both the Finance Committee and private sector forecasters. The most recent information has been incorporated to ensure that the assumptions are current and prudent.

Three key variables affect in a significant way the fiscal forecast: real growth and inflation (which together determine nominal GDP growth) and interest rates. Prudent projections have been adopted for each. Consequently, while any of these variables individually could turn out differently than assumed, taken together they reduce the likelihood that the deficit will be higher than expected. Indeed, changes may have offsetting effects on the deficit, as they did in 1994 when both interest rates and real growth were higher than expected. As described later in this document, there is also a fiscal *contingency reserve* to further reduce the risk that unanticipated economic or interest rate developments could cause the government to exceed its deficit targets.

The Canadian Economy is Expanding Strongly

After several years of lacklustre performance, the Canadian economy is now expanding strongly, led by exports and business investment. While the strength of the expansion has significantly reduced the amount of spare capacity, output remains below its full capacity level, keeping inflation pressures low.

- Real output grew about 4¼ per cent in 1994, the fastest in the G-7.
- In the past year, 433,000 jobs have been created – all of them full-time. The unemployment rate has fallen 1.7 percentage points, although at 9.7 per cent, it remains too high.
- Manufacturing output is up over 9 per cent in the past year and employment posted its strongest growth in six years.
- Inflation, at 1.5 per cent excluding the effect of the tobacco tax cuts, equals its lowest rate in three decades.
- Unit labour costs in Canada have fallen 1.3 per cent since mid-1993 thanks to excellent productivity performance and restrained wage growth. Unit labour costs in the United States have continued to rise. This has contributed to a turnaround in Canada's relative cost performance, which has now equalled its best level in more than 40 years (Chart 2.1).
- Improved cost performance has led to record-breaking exports, a growing trade surplus and a dramatic improvement in the current account (Chart 2.2). Since improved cost performance affects international trade with a lag, further declines in the current account deficit in 1995 are likely.

Chart 2.1
Canada–U.S. relative unit labour costs (total economy)

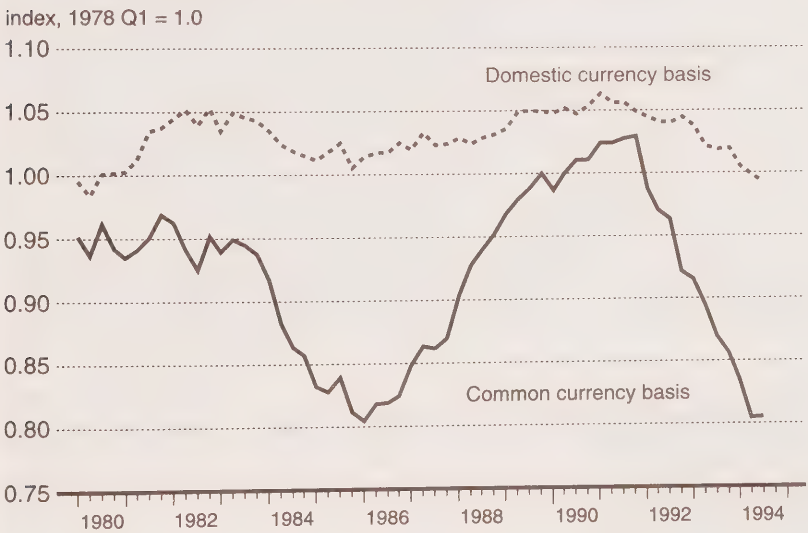
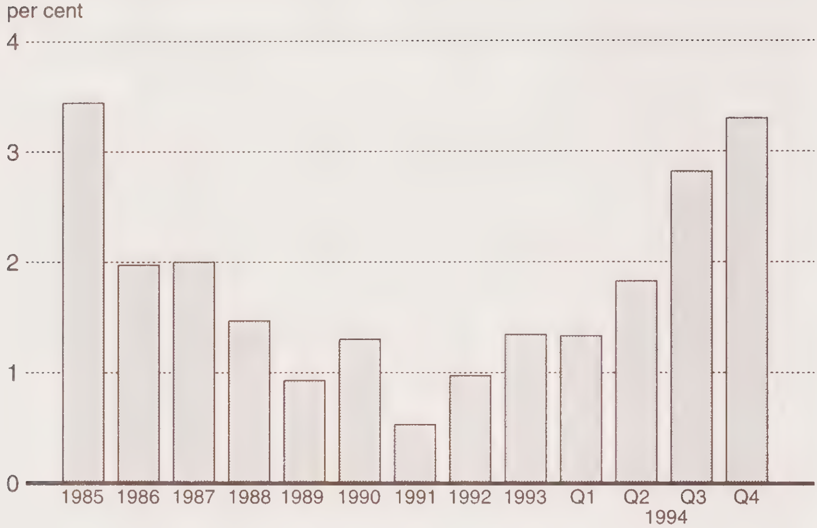
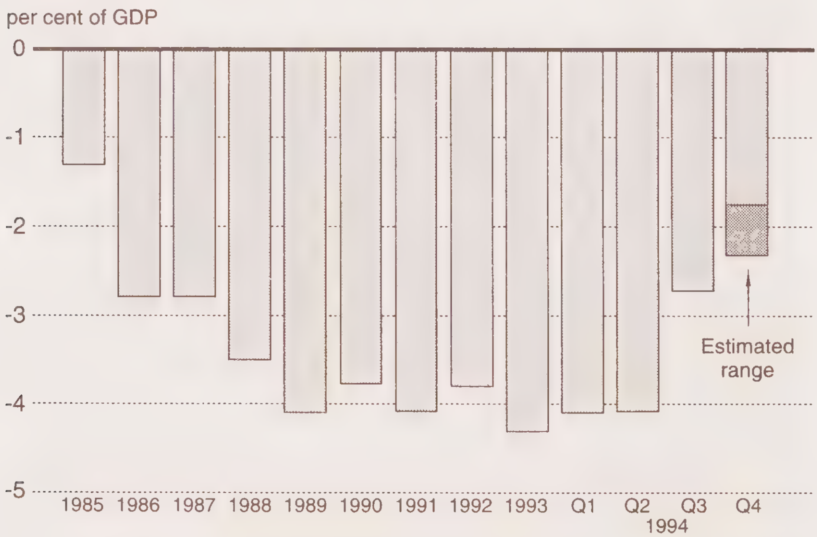


Chart 2.2

Canada's trade position:
Merchandise trade surplus



Current account deficit



■ Business confidence is at its highest level since 1979, due in part to a robust corporate profit performance. Corporate profits, after falling to record lows as a share of GDP in 1992, have risen almost 50 per cent over the past year. This is underpinning solid investment growth. According to a Conference Board of Canada survey, over 80 per cent of firms plan to increase or maintain investment over the next six months.

The External Environment

Major Overseas Economies

Growth in the overseas industrial economies is expected to increase in 1995 and to pick up further in 1996. Recovery is strengthening in the major **European** countries with the performance in Germany and the U.K. being particularly noteworthy. The recovery in **Japan** so far has been hesitant and set back to some extent by the recent earthquake in Kobe, but is generally expected to gain momentum in coming months.

Stronger growth in the major overseas economies is expected to result in a slight rise in inflation by 1996 from low levels. Consequently, the cyclical decline in short-term interest rates is probably over. Indeed, the United Kingdom has already seen some increase in short-term rates in recent months, while German interest rates have stabilized and are expected by many analysts to begin rising soon.

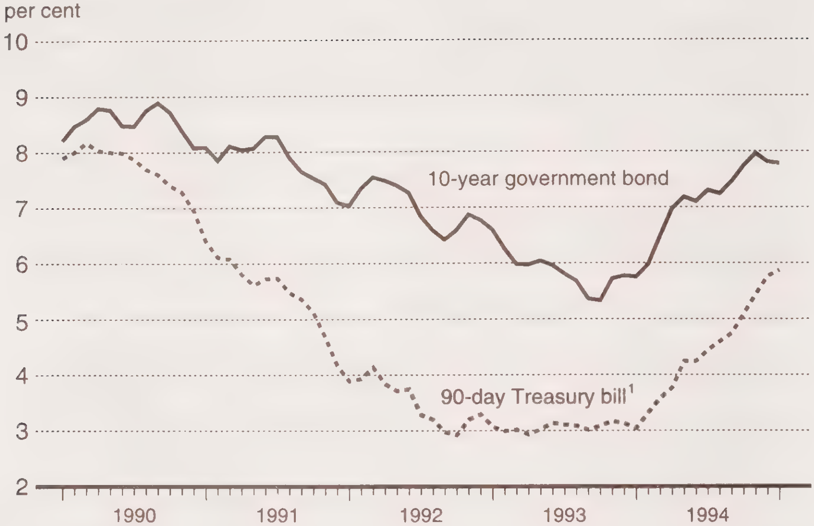
Stronger growth in overseas economies is expected

United States

The U.S. economy has grown at a vigorous pace over the past year, pushing the unemployment rate to its lowest level since September 1990 and raising capacity utilization in manufacturing to its highest level since 1989. As a result, leading indicators of inflation pressures began to rise in early 1994.

The Federal Reserve Board has responded by raising its benchmark interest rate seven times since February 1994, from 3 per cent to 6 per cent, pushing up yields on all maturities (Chart 2.3).

Chart 2.3
U.S. interest rates



[1]True yield basis.

North American growth may be slowing

Long-term interest rates initially rose by an unusual amount in the current episode of monetary tightening reflecting strong inflation expectations. Discretionary moves in mid-November and early February, however, seem to have reassured bond markets, particularly given some indications that growth may be slowing. As a result, long-term rates have eased slightly since mid-November, despite a 125-basis-point rise in short-term rates.

The U.S. economy is reaching a critical point in determining how growth and inflation pressures will play out through the balance of this economic cycle. A gradual slowing in growth and inflation is still possible, an outcome predicted by a majority of private sector forecasters in the U.S. (Table 2.1). There is, however, a substantial risk that the cyclical pattern that has characterized U.S. economic performance over much of the postwar period will be repeated – inflation pressures build and monetary conditions tighten until the economy experiences a sharp slowdown. To be prudent, our planning assumptions for this budget are based on this pessimistic scenario.

Planning assumptions are based on a pessimistic scenario

In particular, it is assumed that U.S. short-term interest rates increase through 1995, reaching a peak of about 7½ per cent at the end of the year, an increase of about 150 basis points from mid-February levels. This is expected to cause U.S. growth to slow

substantially in 1996. The slowdown creates spare capacity that will arrest and eventually reverse the pickup in U.S. inflation, which is assumed to peak at 4 per cent in 1996. In response to the slowdown in growth, interest rates are assumed to fall in 1996 from highs reached late in 1995.

Table 2.1
Comparison of U.S. forecasts

	Real GDP		CPI		3-month bills[1]	
	1995	1996	1995	1996	1995	1996
			(per cent)			
Finance Canada						
Economic assumptions	3.2	1.0	3.5	4.0	7.0	6.5
U.S. Administration						
February	2.8	2.5	3.1	3.2	6.1	5.7
Private sector survey						
(Blue Chip) February	3.1	2.2	3.2	3.6	6.4	6.4
IMF October	2.5	–	3.4	–	5.7	–
OECD December	3.1	2.0	3.1[2]	3.6[2]	6.7	6.9

[1] True yield basis – source, Department of Finance.
[2] Personal consumption deflator.

The Economic Assumptions for Canada

Interest Rates

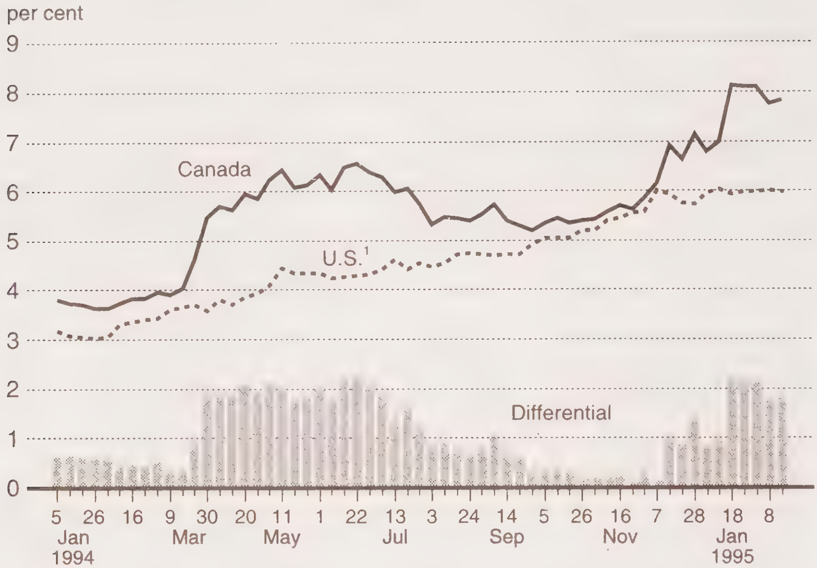
In mid-February, short-term interest rates were about 8 per cent, up more than 400 basis points from 20-year lows in January 1994. Some upward pressure has come from rising U.S. rates, but the Canada–U.S. interest rate differential also has widened reflecting financial market concerns regarding Canada's public debt as well as uncertainty related to the Quebec referendum (Chart 2.4).

Short-term interest rates are assumed to average 8.5 per cent and long-term rates 9.7 per cent this year. In 1996, short-term interest rates are assumed to fall 100 basis points, narrowing the Canada–U.S. differential from 150 basis points in 1995 to an average of 100 basis points in 1996.

These interest rate assumptions represent a prudent approach to budget planning. Economic fundamentals clearly favour a more substantial narrowing of Canada–U.S. interest rate differentials:

- all levels of government in Canada are committed to deficit reduction;

Chart 2.4
Canada–U.S. comparison
3-month Treasury bills



[1]True yield basis.

- inflation has been substantially lower in Canada than in the U.S. since 1992 and is likely to remain so over the next several years; and
- the deficit in the current account of the balance of payments has declined dramatically due to the strengthening trade surplus. Further declines are likely in response to Canada's much improved relative cost performance.

Output and Inflation

Growth is predicted to slow in the latter part of 1995

Strong employment growth since January 1994, combined with continued good trade performance, means that growth in the first half of 1995 is likely to sustain the momentum established in 1994, despite relatively high interest rates. Growth is predicted to slow in the latter part of 1995 as higher interest rates further weaken household spending, while export expansion is moderated by slower U.S. growth. For 1995 as a whole, real growth of about 3¾ per cent is now likely. As the U.S. slowdown deepens next year, real growth in Canada could slip to 2.5 per cent in 1996.

Spare capacity will persist as real growth slows

The good economic performance in 1994 and 1995 will substantially reduce, but not eliminate, the amount of spare capacity in the economy. Spare capacity will persist through 1996 as real growth slows, keeping underlying inflation in the 1½-to-2-per-cent range for both 1995 and 1996, similar to the rate in 1994, net of the tobacco tax cuts[1].

The economic assumptions underlying the fiscal projections in the budget are presented in Table 2.2. It is emphasized that these economic assumptions are deliberately biased toward prudence – i.e. the government believes there is a better than even chance that the actual outcome, overall, will be more favourable. This reflects the fact that the cost of being wrong, in terms of the fiscal consequences, is simply too high.

Table 2.2
Economic assumptions

	Actual	Actual[1]	Assumption	
	1993	1994	1995	1996
Real GDP growth (%)	2.2	4.3	3.8	2.5
GDP deflator increase (%)	1.1	0.6	1.6	1.8
Nominal GDP				
$ billion	712	746	787	821
Growth (% change)	3.4	4.9	5.5	4.3
CPI inflation rate (%)	1.8	0.2	1.8	1.8
Employment growth (%)	1.3	2.1	3.0	2.0
Unemployment rate (%)	11.2	10.4	9.5	9.4
91-day Treasury bill[2] (%)	4.8	5.5	8.5	7.5
10-year benchmark government bond rate (%)	7.2	8.4	9.7	9.0

[1] The GDP figures are estimates.

[2] The rate on 90-day commercial paper, which is approximately 20 basis points higher than the 91-day Treasury bill rate, was used in the February 1994 budget and the October Update. The change was made since the Treasury bill rate is more relevant for debt-servicing costs.

Comparison With Private Sector Projections

A survey taken in early February shows that the government's assumptions about the key economic variables that affect the deficit are more cautious than the average private sector projection (Table 2.3).

[1] The underlying (excluding food and energy) rate of CPI inflation was 0.1 per cent in 1994. Excluding the impact of the tobacco tax cuts, this rate was about 1¾ per cent.

Table 2.3
Comparison of the economic assumptions with other forecasts[1]

	1995	1996
Real output growth (%)		
Budget	3.8	2.5
Private sector average	3.9	2.9
IMF	3.8	–
OECD	4.2	3.9
GDP deflator increase (%)		
Budget	1.6	1.8
Private sector average	1.6	2.2
IMF	1.8	–
OECD	2.1	2.0
Nominal GDP (% change)		
Budget	5.5	4.3
Private sector average	5.5	5.1
IMF	5.6	–
OECD	6.3	6.0
Nominal GDP ($ billions)		
Budget	787	821
Private sector average	787	827
IMF	786	–
OECD	793	840
91-day Treasury bill rate (%)		
Budget	8.5	7.5
Private sector average	7.8	6.9
IMF	–	–
OECD[2]	6.2	6.2
10-year government bond rate (%)		
Budget	9.7	9.0
Private sector average	9.0	8.4
IMF	–	–
OECD[3]	8.4	7.7

1 There are 18 forecasters in the survey of private sector forecasters. The survey was conducted over the February 2-9 period.

2 Three-month commercial paper rate adjusted to equivalent three-month Treasury bill rate.

3 Rate on 10-year-and-over government bonds adjusted to equivalent 10-year rate.

■ Views on real growth and inflation are similar for 1995, but for 1996, the government's assumptions are below the private sector average. As a result, the government's projection for nominal GDP, a good proxy for the overall tax base, is also lower in 1996.

■ Short- and long-term interest rate assumptions are higher than the private sector outlook – by 70 basis points in 1995 and 60 basis points in 1996.

The IMF and the OECD also prepare forecasts of the Canadian economy. Their latest forecasts were prepared before the run-up in interest rates. The IMF forecast, available only for 1995, is similar to the private sector average. The OECD, however, projects lower interest rates, stronger growth and higher inflation than the private sector average.

Comparison With Previous Economic Assumptions

The evolution of the government's economic assumptions since the February 1994 budget is shown in Table 2.4. Real GDP growth in 1994 was much stronger than expected in the 1994 budget or the October Update. The growth forecast for 1995 is little changed. The major change to the economic assumptions over the past year relates to interest rates, which have been revised upwards significantly for both 1995 and 1996. Partly as a result, the real GDP growth assumption for 1996 has been lowered.

Table 2.4
Evolution of the economic assumptions

	1994	1995	1996
Real GDP growth (%)			
February 1994 budget	3.0	3.8	
October Update – Scenario 3	4.0	3.6	3.6
February 1995 budget	4.3	3.8	2.5
GDP inflation (%)			
February 1994 budget	0.9	1.4	
October Update – Scenario 3	0.5	1.1	1.4
February 1995 budget	0.6	1.6	1.8
Nominal GDP ($ billions)			
February 1994 budget	739	778	
October Update – Scenario 3	744	779	818
February 1995 budget	746	787	821
Employment growth (%)			
February 1994 budget	1.4	2.5	
October Update – Scenario 3	2.0	2.6	2.5
February 1995 budget	2.1	3.0	2.0
3-month Treasury bill (%)			
February 1994 budget	4.3	4.8	
October Update – Scenario 3	5.5	7.0	6.4
February 1995 budget	5.5	8.5	7.5
10-year benchmark government bond (%)			
February 1994 budget	6.4	6.1	
October Update – Scenario 3	8.4	9.2	8.5
February 1995 budget	8.4	9.7	9.0

3

Status quo fiscal implications of the economic assumptions

Changes From the 1994 Budget Forecast

The 1994 budget forecast that the deficit would decline to \$39.7 billion in 1994-95 (including a contingency reserve of \$2.4 billion) and to \$32.7 billion in 1995-96. That forecast was based on expectations of improved economic growth, a moderate rise in interest rates, and the impact of significant restraint measures introduced in the 1994 budget.

Interest rates have in fact risen by much more than anticipated last year, with short-term rates in 1994 more than 1 percentage point higher than had been forecast and long-term rates 2 percentage points higher. Interest rates in 1995 are also now expected to be substantially higher than forecast in last year's budget – with the yield on three-month Treasury bills averaging 8.5 per cent in 1995, rather than 4.8 per cent as assumed a year ago.

Interest rates have risen by much more than anticipated

1994-95

The higher-than-expected interest rates have added \$1 billion to public debt charges in 1994-95 compared with last year's budget outlook (Table 3.1). The increase is somewhat less than had been

expected in the October 1994 Update, as the spike in rates came somewhat later, and financing requirements were somewhat lower, than expected.

Table 3.1
Changes to the February 1994 budget deficit track with unchanged policy

	1994-95	1995-96
	(billions of dollars)	
February 1994 budget deficit track	39.7	32.7
Projected impact on deficit due to economic and technical factors		
Tax revenues	-0.2	1.4
Non-tax revenues	-1.0	-1.2
Total impact on deficit of revenue changes	-1.2	0.2
Unemployment insurance benefits	-3.0	-2.9
Other spending	1.2	0.3
Total impact on deficit of program spending changes	-1.9	-2.6
Impact of public debt charges	1.0	7.5
Impact of contingency reserve	-2.4	0.0
Total changes in projected deficit	-4.4	5.0
Revised deficit with unchanged policy	35.3	37.7

Notes: (-) indicates a reduction in the deficit.
(+) means an increase in the deficit.

Numbers may not add due to rounding.

Cash transfers to provinces will be higher than previously expected

The impact of higher interest rates on the 1994-95 deficit has been more than offset by lower program spending and higher budgetary revenues. Program spending for 1994-95 is now estimated at $118.3 billion, $1.9 billion below that forecast in the February 1994 budget (excluding the Contingency Reserve). Virtually all of this improvement is due to lower-than-expected unemployment insurance benefits, as much healthier labour market conditions have lowered the number of beneficiaries. In contrast, cash transfers to provinces will be higher than previously expected, as weakness in income growth in 1993 resulted in downward adjustments to the value of tax point transfers under Established Programs Financing. Most other components of program spending have been restrained by measures introduced in last year's budget.

Budgetary revenues are expected to be $1.2 billion higher than forecast in the February 1994 budget. Virtually all of this improvement is due to higher non-tax revenues, reflecting higher Exchange Fund earnings because of the higher-than-expected interest rates and depreciation of the Canadian dollar. Total tax revenue is little changed, with higher corporate income tax collections offsetting lower personal income tax collections.

Budgetary revenues are expected to be higher than forecast

With lower program spending more than offsetting higher public debt charges, the underlying deficit for 1994-95 is expected to be $4.4 billion lower than the target of $39.7 billion set in the February 1994 budget.

1995-96

For 1995-96, higher interest rates are expected to have much more serious consequences for the fiscal outlook. Public debt charges are now forecast to be $7.5 billion higher than in last year's budget outlook (Table 3.1). All of this increase is due to the increase in interest rates, as financing requirements are somewhat lower than estimated in last year's budget.

The *status quo* revenue projections for 1995-96 have not changed appreciably since the February 1994 budget. However, as in 1994-95, there are marked differences among the components – with personal income tax collections expected to be lower and corporate income tax and other revenues higher. Program spending is expected to be $2.6 billion lower than forecast in the February 1994 budget. As in 1994-95, most of this improvement is attributed to much lower-than-expected unemployment insurance benefits. The contingency reserve remains at $2.5 billion, the level set in the October Update.

Hence, in the absence of the new policy measures proposed in this budget, the deficit would be pushed up substantially, entirely because of higher public debt charges.

Status Quo Deficit Outlook to 1996-97

This fiscal outlook includes a contingency reserve

The *status quo* deficit outlook is shown in Table 3.2. The projected deficit *before* the actions to be taken in this budget is based on the prudent economic assumptions set out in Table 2.2. This fiscal outlook includes a contingency reserve against unforeseen developments of $2.5 billion in 1995-96 and $3 billion in 1996-97.

Table 3.2
Summary statement of transactions
Status quo

	1993-94	1994-95	1995-96	1996-97
		(billions of dollars)		
Budgetary transactions				
Budgetary revenues	116.0	125.0	131.8	135.5
Program spending	-120.0	-118.3	-117.6	-116.7
Operating balance	-4.0	6.7	14.2	18.8
Public debt charges	-38.0	-42.0	-49.5	-50.7
Underlying deficit	-42.0	-35.3	-35.3	-31.9
Contingency reserve			2.5	3.0
Deficit	-42.0	-35.3	-37.7	-34.9
Non-budgetary transactions	12.2	9.3	9.7	11.3
Financial requirements (excl. foreign exchange transactions)	-29.8	-26.0	-28.1	-23.6
Net public debt	508.2	543.5	581.3	616.2
Gross domestic product	711.7	746.4	787.1	821.3
Percentage of GDP				
Budgetary revenues	16.3	16.7	16.7	16.5
Program spending	16.9	15.8	14.9	14.2
Public debt charges	5.3	5.6	6.3	6.2
Deficit	-5.9	-4.7	-4.8	-4.2
Financial requirements	-4.2	-3.5	-3.6	-2.9
Net public debt	71.4	72.8	73.8	75.0

Notes: (-) indicates a net requirement for funds.
(+) indicates a source of funds.
Numbers may not add due to rounding.

Shortfalls from target will be made up by fiscal actions in this budget

On a *status quo* basis, the deficit in 1995-96 is now forecast to be $37.7 billion or $5.0 billion above the target of $32.7 billion established in last year's budget. In 1996-97, the deficit, in the absence of new fiscal actions, is projected to decline only to $34.9 billion, $10.6 billion above the level required to meet the government's interim deficit target of 3 per cent of GDP or $24.3 billion. These shortfalls from target will be made up by fiscal actions in this budget. They are somewhat higher than those resulting from the most prudent economic scenario projected in the October Update and also higher than those presented in the House of Commons Finance Committee report last December.

Even without the additional policy actions required to meet the fiscal targets, program spending is expected to decline in each of the next two fiscal years. In 1996-97, program spending is expected to be $1.6 billion lower than in 1994-95 and $3.3 billion below the final outcome for 1993-94. This decline reflects lower unemployment insurance benefits and the effects of the restraint measures announced in the last budget.

The Need for Policy Action

In the *status quo* forecast, program spending is projected to decline both in real terms and as a share of GDP. Revenues are projected to grow roughly in line with the growth in the economy. Thus the operating balance – that is, the excess of revenue over program spending – is projected to increase substantially. Nevertheless, in the absence of offsetting fiscal actions, federal net debt would increase to a postwar record high of 75.0 per cent of GDP by 1996-97. Federal debt has, in fact, increased relative to GDP virtually without interruption since 1974. Since GDP is a rough measure of the national capacity to service public debt, it follows that a steadily rising ratio of public debt to GDP is unsustainable.

The *New Framework for Economic Policy* described in detail the dynamics of the vicious circle of deficits and debt. It explained how budget policy must generate sufficiently large operating surpluses to offset the compounding effect of interest. Otherwise, the debt ratio would rise exponentially so long as the effective interest rate on the debt exceeded the growth rate of the economy (as has been the case since the early 1980s). This basic fact of arithmetic is the essence of the fiscal challenge.

In 1994-95, public debt charges are expected to be $42 billion, or $4 billion higher than a year ago. This single year *increase* exceeds the budgets of the Departments of Agriculture and Agri-Food, Citizenship and Immigration, Environment, and Justice combined.

Of the increased debt charges, $2.5 billion is due to interest on the new debt accumulated in 1994-95 and $1.5 billion is due to higher interest rates in 1994-95 applied to the accumulated stock of federal debt, expected to be $543.5 billion by the end of this fiscal year. This illustrates Canada's vulnerability to higher interest rates whether arising from foreign or domestic causes.

High deficits and debt lead to higher interest rates, higher taxes and reduced confidence

The October Update showed how Canada's rising public debt has become a major obstacle to sustained economic growth and job creation. High deficits and debt lead to higher interest rates, higher taxes and reduced confidence, which dampen investment and growth. The financial requirements flowing from chronic deficits, when not matched by increases in private sector savings, increase Canada's dependence on foreign borrowing, the servicing cost of which is a permanent drain on national income and future living standards.

The cost of financing deficits also reduces the government's capacity to provide important public services and to make adequate investments in areas of strategic national importance such as science and technology and export market development.

The current fiscal situation is all the more serious because there was insufficient action taken during the strong growth period of 1984 to 1989. That mistake must not be repeated. Only strong and *continued* fiscal discipline will break the cycle of rising debt and deficits and create the conditions for durable economic expansion.

The structure of federal government spending must be permanently changed

In summary, fiscal health cannot be restored simply by meeting the deficit targets in the next two years. Meeting those targets is necessary, but not sufficient. The more fundamental purpose of the fiscal actions in this budget is to change permanently the *structure* of federal government spending, and thus reach the ultimate goal of a balanced budget.

4

Budget measures

The Plan for Fiscal Action

The primary economic objective of the government – to sustain strong growth and job creation – can be achieved only in a healthy fiscal environment. This budget is aimed at creating such an environment.

Healthy fiscal environment leads to sustained growth and job creation

To that end, the actions announced in the budget:

- reform government programs and procedures to eliminate waste and abuse and ensure value for the taxpayer's dollar;
- deliver a new vision of the federal government's role in the economy that includes substantial reductions in business subsidies;
- reform the major federal transfers to the provinces to better reflect responsibilities and fiscal requirements; and
- set the fiscal parameters within which labour market programs will be redesigned to foster increased employability.

These measures address major components of government spending – spending by government departments including subsidies to business; transfers to other levels of government; and unemployment insurance. Savings will be achieved in all these areas. The changes are structural. They ensure not only that short-term savings are secured but also that spending *remains* under control.

Complementary to these major spending reductions is a small number of taxation measures that remove tax preferences, increase tax fairness, and ensure that the deficit targets are met. Over the next three years, expenditure reductions predominate over new revenues by a cumulative ratio of nearly seven to one.

Taken together, these measures will produce cumulative fiscal savings of $29.0 billion over the next three years and constitute the most far-reaching reform of federal program activity in the post-war era. With the reforms, federal program spending will decline by 8.8 per cent by 1996-97 from its current level (excluding the restructuring charges in 1994-95 associated with this budget), by far the largest reduction since post-war demobilization 50 years ago.

Getting Government Right

Program Review

The Program Review was announced in the 1994 budget "to ensure that the government's diminished resources are directed to the highest priority requirements and to those areas where the federal government is best placed to deliver services". Its main objective was to review all federal programs in order to bring about the most effective and cost-efficient way of delivering programs and services that are appropriate to the federal government's role in the Canadian federation.

Comprehensive review of government spending...

The Program Review process was fundamentally different from those tried in the past. Ministers were asked to review their own portfolios and provide their view on the federal government's future roles and responsibilities. Ministers were asked to undertake this review of government programs and activities using six tests: serving the public interest; necessity of government involvement; appropriate federal role; scope for public sector/private sector partnerships; scope for increased efficiency; and affordability.

Over the course of fall 1994, departments prepared Action Plans outlining their strategic priorities and proposals. These plans were reviewed by a Committee of Ministers, which was asked by the Prime Minister to review the operations of government and help Cabinet come to informed decisions about the federal government's core roles and responsibilities. The Program Review encompassed about $52 billion worth of spending, excluding only major statutory transfers.

The Program Review will lead to long-lasting structural change in *what* the government does.

...leading to structural change

- No longer will the federal government own, operate and subsidize large parts of Canada's transportation system. It will instead focus on core policy and regulatory responsibilities and ensuring the safety and security of the system. These changes represent major fundamental reforms to Canada's transport system.

- In the past, agricultural subsidies have been tied to specific commodities, resulting in a large number of programs. The Program Review will help establish an integrated, whole-farm approach to the government's farm safety net program which emphasizes income stabilization rather than income support.

- The Program Review led the Department of Fisheries and Oceans (DFO) to focus its resources on science and regulation to ensure conservation and sustainable use of Canada's ocean resources. Responsibility for oceans management will be consolidated within DFO, and the government will discuss with the provinces the potential devolution of freshwater fisheries management.

- The business community has often stated that it does not need or want the level of assistance it receives from the federal government. In the Program Review subsidies to business will be reduced by 60 per cent. More importantly, the remaining assistance will be largely in the form of loans and other repayable contributions.

In other areas, there will be fundamental change in *how* the government delivers programs and services. For example:

- An immigration fee and sponsorship financial guarantees will be used to promote self-reliance among newcomers to Canada, reduce costs to taxpayers, and shift more responsibility to those who directly benefit from the management of Canada's immigration programs.

- While Environment Canada's core role in promoting sustainable development will be maintained, this role will increasingly be carried out in cooperation with other governments and the non-governmental sector. As a result of the Program Review, Environment Canada will shift away from local issues and service delivery and towards research and policy.

- Many departments will alter the way they deliver services to increase efficiency and improve services to Canadians.

It is clear that the Program Review has helped address concerns Canadians have had on the way the federal government is organized and the way it spends tax dollars. As Table 4.1 shows, departmental spending will be cut by $3.9 billion in 1995-96, $5.9 billion in 1996-97 and $7.2 billion in 1997-98 relative to what would have been the case without Program Review.

The expenditure reductions reflect government priorities as well as the scope for program rationalization and efficiency improvements.

The largest percentage declines in spending will take place in Transport, Industrial and Regional support programs, where spending will fall by about half between 1994-95 and 1997-98 (Table 4.2). This principally reflects sharp reductions in business subsidies. Spending on science and technology by the science agencies of Industry Canada's portfolio, will be reduced by proportionally less than the average decline in the Department of Industry, Regional and Scientific-Technological programs, reflecting the importance of government support for R&D.

Defence spending will also fall sharply, declining by $1.6 billion between 1994-95 and 1997-98. The cuts in defence spending resulting from this budget reflect the 1994 *Defence White Paper* and are in addition to large reductions announced in last year's budget.

Respecting the government's commitment to protect the most vulnerable and ensure public safety, the smallest percentage reductions will occur in departments dedicated to social programs, justice and corrections.

Spending 18.9 per cent lower in three years

In almost all cases the cuts will be on top of planned spending levels that were *already* declining as a result of decisions in the February 1994 budget. Hence, by 1997-98, spending subject to the Program Review will have declined 18.9 per cent relative to 1994-95. Spending levels will be halved in some departments. A detailed discussion of major decisions and the sources of savings for each department is presented in Chapter 6.

Table 4.1
Departmental savings under Program Review[1]

	1995-96	1996-97	1997-98
	(millions of dollars)		
Natural Resource Sector	**328**	**380**	**581**
Agriculture	215	128	272
Fisheries and Oceans	51	80	110
Natural Resources	26	82	68
Environment	35	90	131
Transport	**555**	**953**	**1,111**
Industrial, Regional and Scientific-Technological Support Programs	**508**	**476**	**581**
Industry (and specified agencies)	93	148	212
Science and Technology Agencies[2]	71	108	142
Regional Agencies	144	220	227
Infrastructure	200		
Justice and Legal Programs	**32**	**59**	**75**
Justice	6	12	17
Solicitor General	25	47	58
Heritage and Cultural Programs	**142**	**274**	**387**
Foreign Affairs and International Assistance	**490**	**515**	**711**
Foreign Affairs/International Trade	109	134	171
International Assistance Envelope	381	381	540
Social Programs	**877**	**1,580**	**1,771**
Citizenship and Immigration	100	69	103
Health	49	138	201
Human Resources Development	600	1,100	1,100
Indian Affairs and Northern Development	5	97	177
Canada Mortgage and Housing	64	115	128
Veterans Affairs	59	61	62
Defence/Emergency Preparedness	**350**	**557**	**1,033**
PUITTA[3]	**200**	**276**	**280**
General Government Services[4]	**232**	**391**	**523**
Parliament/Governor General	**3**	**8**	**15**
Expenditure Management System	**150**	**150**	**150**
Other Program Review (unallocated)		**250**	
Total	3,867	5,869	7,217

[1] Savings include additional cost-recovery revenues that appear in non-tax revenues.

[2] Includes granting councils, the Canadian Space Agency and the National Research Council.

[3] *Public Utilities Income Tax Transfer Act.*

[4] Includes Central Agencies, Public Service Commission, Statistics Canada, National Revenue, Parliament, and Public Works and Government Services.

Numbers may not add due to rounding.

Table 4.2
Federal departmental spending after Program Review[1]

	Spending levels		Change	
	1994-95	1997-98	$ millions	per cent
	(millions of dollars)			
Natural Resource Sector	**4,847**	**3,333**	**-1,514**	**-31.2**
Agriculture	2,073	1,628	-445	-21.5
Fisheries and Oceans	775	565	-211	-27.2
Natural Resources	1,262	638	-624	-49.4
Environment	737	503	-234	-31.8
Transport	**2,851**	**1,404**	**-1,447**	**-50.8**
Industrial, Regional and Scientific-Technological Support Programs	**3,798**	**2,355**	**-1,443**	**-38.0**
Industry (and specified agencies)	1,301	742	-560	-43.0
Science and Technology Agencies[2]	1,359	1,038	-321	-23.6
Regional Agencies	1,138	576	-562	-49.4
Justice and Legal Programs	**3,298**	**3,132**	**-166**	**-5.0**
Justice	757	693	-64	-8.4
Solicitor General	2,541	2,439	-102	-4.0
Heritage and Cultural Programs	**2,897**	**2,221**	**-676**	**-23.3**
Foreign Affairs and International Assistance	**4,082**	**3,292**	**-789**	**-19.3**
Foreign Affairs/International Trade	1,488	1,231	-257	-17.3
International Assistance Envelope	2,594	2,061	-532	-20.5
Social Programs	**13,003**	**12,013**	**-990**	**-7.6**
Citizenship and Immigration	663	601	-62	-9.4
Health	1,815	1,746	-70	-3.8
Human Resources Development	2,544	1,660	-885	-34.8
Indian Affairs and Northern Development	3,761	4,208	447	11.9
Canada Mortgage and Housing	2,131	1,942	-189	-8.9
Veterans Affairs	2,088	1,857	-232	-11.1
Defence/Emergency Preparedness	**11,574**	**9,925**	**-1,648**	**-14.2**
PUITTA	**250**	**0**	**-250**	**-100.0**
General Government Services	**4,967**	**4,137**	**-831**	**-16.7**
Parliament/Governor General	**309**	**277**	**-32**	**-10.2**
Total	51,875	42,089	-9,785	-18.9
Per cent of GDP	7	5		

[1] As noted in Table 4.1, Program Review resulted in additional deficit reduction through increases in cost recovery and revenue generation. These savings are not reflected in this Table.

[2] Includes granting councils, the Canadian Space Agency and the National Research Council.

Numbers may not add due to rounding.

Increased Efficiency Through Better Management

Control over spending becomes permanent feature of government management

As announced by the President of the Treasury Board on February 15, a new **Expenditure Management System** (EMS) will be implemented to ensure that the scrutiny of government spending initiated in Program Review becomes a permanent feature of public sector management. Departments will no longer have access to pools of "central funds" for new policy initiatives. Funding for new initiatives will have to come from reallocations within *existing* budgets.

The EMS will require departments to prepare business plans indicating program changes to be accommodated within declining resource levels. This requirement will greatly improve planning and evaluation of effectiveness. Business plans will indicate audit and evaluation priorities, which will link program performance to the budgetary process.

Department outlook documents setting out future year spending plans and priorities will be presented to the Standing Committees of the House of Commons, thereby allowing Parliamentary and public scrutiny. Program evaluation is being strengthened throughout government through the publication of evaluations and audits, the identification of evaluation and review priorities in departmental business plans, and the publication of service standards by departments.

The EMS will ensure that programs are permanently subject to strict cost control and evaluation. The elimination of policy reserves and the discipline of the EMS will make permanent the process of resource reallocation started in Program Review. Thus, operating reserves will be smaller than in past years, which will lead to savings of $150 million per year. The ongoing examination of programs will yield savings of at least an additional $250 million in 1996-97. These savings are reflected in the Program Review total in Table 4.1, but have not yet been allocated across departments.

The **Auditor General of Canada** will be reporting to Parliament more frequently – up to five times annually, including an environmental audit (following Royal Assent to proposed legislation) – in order to identify and eliminate waste and mismanagement before they become chronic problems. Actions announced in this budget already go a long way to meeting concerns the Auditor General of Canada has raised about management of resources in the government.

Follow-up to Auditor General's recommendations

The Auditor General of Canada has made a number of suggestions in the areas of the performance of the tax system, reduction of duplication and overlap with the provinces, program evaluation, comptrollership, human resource management and reporting of financial and performance information. These suggestions are being examined, and actions have already been taken to meet many of his concerns. The response of the government to these and other recommendations of the Auditor General of Canada is contained in Annex 2.

In addition, following suggestions by the Auditor General of Canada, the government published last fall its first *Annual Financial Report*, which contains a "scorecard" of key fiscal and financial indicators.

In response to the concerns of the Auditor General of Canada regarding accounting practices, the government intends to adopt "full accrual accounting", which is comparable to private sector practice. The principal changes will be the capitalization of physical assets and accounting of tax revenues on an accrual rather than cash basis. Currently, physical assets are treated as expenditures at the time they are acquired. Under full accrual accounting, their costs would be spread over their useful lives through annual depreciation charges. This change will better enable the government to report the true cost of programs and improve accountability. By accounting for tax revenues on an appropriate accrual basis, such revenues will be classified to the year to which they relate rather than when they were received. As such, proper recognition will be given to tax receivables.

The government will **replace the $2 note** now circulating with a $2 coin in early 1996. Substantial savings will result from on-going efficiencies in production and handling costs relative to the $2 note. The government will consult on implementation issues.

Building on the new escalating rate Canada Savings Bond introduced last year, the government will be launching a new **retail debt program**. The objective of this initiative is to provide Canadians with greater opportunity to invest in Canada thereby reducing the reliance on foreign investors. This initiative will bring important benefits to Canadians by providing them better access to a family of safe and secure Government of Canada obligations.

Program Review will result in **wide-ranging improvements to programs** – both their administration and their delivery.

Streamlined government operations

■ The operations of the Canadian Coast Guard will be integrated with the Department of Fisheries and Oceans, in order to achieve greater efficiency in the use of resources and infrastructure.

■ The departments of Fisheries and Oceans, Environment Canada and Transport Canada will rationalize their freshwater and marine responsibilities, resulting in streamlining and better service to clients.

■ Public Works and Government Services Canada will consolidate its cheque production and data centres.

■ Revenue Canada will achieve efficiencies in its enquiries process. In addition, to encourage prompt payment of taxes and instalments, the interest rate charged on late or deficient payments will be increased by two percentage points, effective July 1, 1995. The new rate will apply to overdue income tax payments, insufficient income tax instalment payments, unpaid employee source deductions and other amounts withheld at source, unpaid Canada Pension Plan contributions, unpaid unemployment insurance premiums and unpaid penalties.

■ Health Canada, Agriculture and Agri-Food Canada, Fisheries and Oceans and Industry Canada will work cooperatively on measures, including possible changes in organizational structure, to improve the effectiveness and cost efficiency of the federal component of the Canadian food inspection system. This will be done in consultation with the food industry and the provinces.

■ The refugee determination system will be streamlined, resulting in a faster, more efficient process.

■ Health Canada will rationalize its network of laboratory services.

■ Improvements in the administration of the Unemployment Insurance program will save a minimum of $200 million per year. These measures will include computerized matches to ensure that individuals with other sources of income from work or social assistance do not receive full unemployment insurance benefits, and group information sessions to inform claimants of job opportunities in their area so that they can be placed in a job and end their unemployment insurance claim.

■ The government will vigorously pursue more productive and streamlined operations through innovative service delivery, information technology, and sharing of common services among departments. It will improve its internal management of year-end spending, travel and conferences, and the size of its automobile fleet,

for example. Another area for action is replacing Ministers' Regional Offices with space in existing government offices. The Treasury Board will be taking the necessary actions to pursue these directions.

- The results of a government-wide review of agencies, boards, commissions and advisory bodies were announced on February 16. As a result of this review, decisions have been taken affecting 120 agencies, commissions, boards and advisory bodies. Seventy-three of these affected agencies will be wound-up and the remaining 47 will be restructured and streamlined. These decisions will result in eliminating 665 Governor-in-Council positions, hundreds of Ministerial appointments and will save about $10 million annually.

Cost Recovery and Other Fees

Increased fees for services that confer a private benefit

It is appropriate that certain programs be financed at least partly through increased cost recovery and user fees, especially for those services that confer a private benefit. This is consistent with relying more heavily on market incentives and forcing a more cost-conscious and client-oriented government.

A number of departments will therefore be introducing new cost-recovery initiatives or increasing existing fees to cover a greater proportion of the costs of certain programs. Examples include fees for food and meat inspection, drug approvals, fisheries inspection, fishing licences, and marine services.

Assumed revenues from cost recovery announced in previous budgets have not always materialized. Henceforth, department spending allocations will be linked to cost-recovery projections. This means that if a department falls short of the revenue projected from cost recovery, spending will have to be cut to make up the difference.

As a part of a new direction for Canada's immigration and citizenship policy, outlined last fall in the Minister of Citizenship and Immigration Canada's *Strategic Framework*, several measures will be introduced to ensure that the program will be made more fair, affordable and sustainable. Two measures will be implemented effective February 28, 1995:

- an immigration fee of $975 per adult immigrant will be imposed so that direct beneficiaries and taxpayers more equitably share the costs of immigration. Loans will be provided in cases of financial hardship to maintain equitable access; and

- the fees for citizenship will also be increased, including a fee for the right of citizenship.

In addition, as outlined in the *Strategic Framework*, a new sponsorship regime is under development for ensuring that sponsors honour their commitments, including some form of a financial guarantee. The guarantee will help ensure that sponsored immigrants do not become a burden on the public purse. At present, the failure of sponsors to support those whom they sponsor costs the provinces as much as $700 million per year in social assistance payments and the federal government millions more in public pension benefits. The specifics of these new sponsorship measures will be announced by the Minister of Citizenship and Immigration in the near future.

The Department of Foreign Affairs and International Trade will be implementing measures to achieve greater cost recovery related to the provision of consular and trade development services. This will shift a greater burden of these costs to the prime users.

The Minister of Environment will develop, in consultation with concerned Ministers, provinces and stakeholders, proposals for recovering costs attributable to environmental assessments as well as options for streamlining procedures and timeline for the environmental assessment process.

Environment Canada will continue to provide weather forecasts, warning and environmental services for the benefit of all Canadians. However, customized services and products, and products for commercial purposes will now be provided on a fee for service basis.

The Department of Indian Affairs and Northern Development will proceed with a comprehensive series of amendments to northern resource management to increase revenues and ensure a fair return to the Crown.

Increased cost recovery will apply within the government as well, forcing government departments to rationalize their purchase of internally provided services including legal advice.

Enhanced cost recovery will generate about $450 million in the first year, rising to $600 million when fully mature. Of this amount, over half relates to the increased interest rate on unpaid taxes and the immigration levy.

Reduced Business Subsidies

Business subsidies to decline 60 per cent

Business subsidies frequently fail to achieve the purpose for which they were originally designed. In the words of the OECD Jobs Study in 1994:

> "Subsidies tend to operate in exactly the opposite way from what is needed: they slow rather than stimulate adjustment; they discourage rather than encourage innovation; and they tend to become permanent."

Decisions taken in the course of Program Review will result in the elimination or substantial reduction of business subsidies across all departments. Total spending on these subsidies will decline from $3.8 billion in 1994-95 to $1.5 billion by 1997-98 (Table 4.3). Thus by 1997-98, business subsidies will have been reduced by 60 per cent from their level in 1994-95.

- *The Western Grain Transportation Act (WGTA)*. The WGTA evolved from the fixed Crow's Nest Pass freight rate established in 1897. In this budget, the federal government is introducing a western grain transportation reform package that will improve the grain transportation system while more effectively meeting our international trade obligations.

Table 4.3
Major business subsidies (grants and contributions)

	1994-95	1997-98
	(millions of dollars)	
Agriculture	1,322	893
Transportation	696	19
Regional development	700	234
Industry, innovation and market development	525	264
Energy and resource sectors	410	8
Cultural industries	104	68
Total Grants and Contributions	3,757	1,486
Per cent reduction (grants and contributions)		60.4

Effective August 1, 1995, the government will be eliminating the annual $560 million subsidy to the railways. At the same time, to reduce the cost and improve the efficiency of the grain handling and transportation system, the shipper-oriented provisions of the *National Transportation Act* (NTA) will apply to the

transportation of Prairie grain. There will be a transition to market-determined freight rates, with legislated maximum freight rates. Measures to facilitate the rationalization of uneconomic branch lines and to change pooling points for Canadian Wheat Board export shipments will also be introduced.

A package of transition measures will be provided as part of the western grain transportation reform. An *ex gratia* capital payment of $1.6 billion will be provided to owners of prairie farm land in recognition of the impact upon land values that may result from the termination of long-standing freight-rate subsidies. In addition, a multi-year WGTA adjustment package of $300 million will be established to facilitate transition to a more efficient transportation system. In recognition of the continuing importance of grain exports, credit guarantees on up to $1 billion of sales will be provided to non-sovereign buyers of Canadian Wheat Board wheat and barley and other agri-food products.

- *Atlantic Region Freight Assistance Act (ARFAA)* and the *Maritime Freight Rates Act (MFRA)*. Under this legislation, which originated in 1927, the National Transportation Agency of Canada compensates carriers for rate reductions on movements originating in the Gaspé and the Atlantic provinces. The subsidies are calculated on a per-shipment basis, and were designed to reduce transportation costs to shippers in the region, especially for shipments to central Canadian markets. The subsidy costs $99 million per year.

These transportation subsidies are inefficient and unaffordable. They will be eliminated on July 1, 1995. A $326 million transportation adjustment program, to be paid over five years, has been established for regions currently receiving ARFAA/MFRA subsidies. Transition programs provided for in federal-provincial agreements will let provinces target assistance to meet local shippers' adjustment needs and to provide for improved infrastructure.

- *Dairy Subsidy.* The subsidy paid to dairy producers will be reduced by 30 per cent over the next two years. The future of the remaining subsidy funds will be reviewed in consultation with the industry and the provinces.

- *Agricultural Safety Net.* The overall funding level for safety net programs, which include the Net Income Stabilization Account, Crop Insurance and the Gross Revenue Insurance Program, will be reduced by 30 per cent over the next three years. Within the remaining funding level, there will be a core national whole-farm stabilization program, crop insurance, and province-specific companion

programs in line with the recent decision of Federal-Provincial Ministers of Agriculture. This package will be more market neutral and encourage more innovation and diversification.

■ *Feed Freight Assistance*. This transportation subsidy will be terminated, and transitional funding will be provided over the next 10 years. The Minister of Agriculture and Agri-Food will consult with industry and the provinces on how the transitional funds will be used to enhance the competitiveness of industry in affected regions.

■ *Industry Canada*. Consistent with the government's broad-based move away from subsidies and direct business support, Industry Canada will further reduce business subsidies. Remaining spending will focus on initiatives in high-growth sectors in partnership with the private sector. All existing programs will come under the most intensive review in order to achieve the savings identified in this budget.

■ *Cultural Industries*. Subsidies to cultural industries under the Department of Canadian Heritage will be reduced, including an 8-per-cent reduction to the postal subsidy (which subsidizes the mailing rates of certain Canadian books and magazines) to be implemented over three years, and reductions resulting from the merger of the Book Publishing Industry Development Program with the Publications Distribution Assistance Program for Books into a restructured book publishing program.

■ Regional Agencies. The government envisages a new role for Canada's regional agencies. They will focus on small- and medium-size enterprises, but they will rely on loans and repayable contributions rather than direct subsidies. The agencies' field offices, and Industry Canada in Ontario, will provide a single point of contact to federal government programming for the small business sector.

The Federal Office of Regional Development-Québec (FORD-Q) plays a major role in the delivery of federal programs and the government's efforts to promote the growth of small- and medium-size enterprises in Québec.

In an effort to facilitate access to capital for small- and medium-size enterprises, the FORD-Q will explore the potential of forging new alliances with the Federal Business Development Bank (FBDB) and other financial institutions. The objective is to ensure that business assistance is delivered more effectively and on more commercial terms.

The Department of Western Economic Diversification Canada (WD) will move to eliminate direct financing assistance provided to individual businesses on a non-commercial basis, while still fulfilling its mandate of diversifying the economy of western Canada.

WD will establish specialized investment funds in co-operation with private and public financial institutions – such as the chartered banks, credit unions, trust companies, co-operatives, the Farm Credit Corporation and the FBDB. These strategic alliances will leverage public funds to provide small businesses, particularly those involved in "new economy" activity, with access to capital where there are identified gaps in financial markets in western Canada. More "patient" capital will be made available, and new lines of business currently not served by commercial institutions will be explored. All financing decisions will be made by the financial institutions based on commercial practices.

The Atlantic Canada Opportunities Agency will continue to work with the provinces and the private sector to increase access to investment capital through support for the establishment of a new, private-sector-operated, Atlantic venture capital fund.

Export Financing

The government will continue to play an appropriate role in supporting exports for companies in sectors facing intense international competition. The Export Development Corporation (EDC), with the help of Industry Canada, is pursuing new, innovative approaches in the area of sales financing. A key feature of the initiative involves partnerships between EDC and Canada's exporters.

Small Business

Support for small business growth and job creation is a central element of the government's economic agenda. Extensive consultations over the past year have identified the major policy concerns of these entrepreneurs, chief among them being the fundamental importance of deficit reduction. In addition, action has been taken on several fronts identified as being crucial to improving the small business climate, including measures to reduce the paper burden on small business, a strategic procurement initiative, expansion of the Canada Business Service Centres, regulatory reform, changes to the *Small Business Loans Act* to move it to full cost recovery, and new

export financing initiatives. In the coming weeks, the Ministers of Finance and Industry Canada will be bringing forward a comprehensive progress report on the small business agenda.

The 1994 budget and subsequent consultations with the small business community placed particular emphasis on the access to capital by small business. New practices and attitudes towards small business on the part of lenders were viewed as essential. Soon after the 1994 budget, a joint Industry-Finance task force was established to work with the banks on access to bank financing and related issues.

Progress has been made during the past twelve months. The banks have announced a number of new programs specifically geared to various needs of entrepreneurs with small- and medium-sized businesses. The banking community has developed a *code of conduct*, which should make the borrowing process more transparent, as well as an impartial mechanism for resolving credit-related disputes.

These are positive developments. However, more can be done. Hearings by the Standing House Committee on Industry and the Small Business Working Committee indicated, for example, that export- and growth-oriented firms continue to face significant financing problems. The success of these firms is a key element in Canada's economic future.

Canada's major banks must play the pivotal role in providing increased access to small business financing. In order to achieve better access, the government will be working with the banking community between now and the fall to elaborate meaningful benchmarks regarding small business lending. Progress during the following year will be monitored against these benchmarks.

Privatization and Commercialization

Privatization of Crown corporations to continue

Government equity holdings, assets and services will be considered for privatization, or at least placed on a more commercial basis wherever this can be shown to improve service and reduce costs while continuing to protect the public interest. Over time, this approach to better management will help to reduce financing requirements, debt servicing costs and the deficit. It will also contribute to better economic performance through increased efficiency, competition and new private sector investment. In addition, the Treasury Board has adopted a framework for alternative service

delivery that will provide guidance to departments on a range of innovative organizational approaches (including privatization) that government could use to deliver services more efficiently.

The government recently sold its remaining interest in Cameco Corporation, a uranium producer, that had been jointly owned with the Government of Saskatchewan and private sector shareholders. In addition, the government's remaining 70-per-cent interest in Petro-Canada will be sold when market conditions are favourable.

Looking forward, the government intends to sell Canadian National (CN). This initiative will provide CN with the necessary freedom to make strategic operating and investment decisions quickly in the future and to seek new sources of private sector capital in order to fund these decisions. The government will also take the necessary steps to revitalize Canada's rail industry. This will include a major reform to the *National Transportation Act* to lighten the regulatory burden which now prevents the industry from providing the flexible service that shippers need. These changes will make the rail industry more efficient and competitive. This will have significant benefits for all Canadians.

As well, the government is committed to commercialize Transport Canada's Air Navigation System and will examine divesting all or parts of the Canada Communication Group. The government will continue to seek opportunities for further privatization and commercialization initiatives.

Defence Expenditure Reductions

Defence spending cut further

Defence policy must be consistent with fiscal realities and yet meet Canada's defence needs. It was within this context that the *1994 Defence White Paper* set out a defence policy which respects the government's commitment to reducing the deficit.

This budget reduces defence spending from planned levels by over $2.8 billion over the next four years. These spending cuts are in addition to the defence expenditure reductions of $7.0 billion in the five-year period beginning 1994-95 introduced in the 1994 budget. These measures will result in annual average reductions in defence program spending of almost 5 per cent each year over the next three years. As a result, defence spending in 1997-98 will be more than 14 per cent lower than in 1994-95.

In implementing these reductions, the Department of National Defence is committed to preserving multi-purpose combat-capable forces to protect Canadian sovereignty and support Canada's multilateral peace and security interests. As the White Paper indicates, the Canadian Forces will become smaller, more flexible, and more efficient. This will involve declining levels of military and civilian personnel, some reductions in infrastructure, and further contraction of capital spending.

Lower Spending on International Assistance

The International Assistance Envelope will be reduced by \$532 million or about 21 per cent over the next three years from planned reference levels, as a result of Program Review. Among the measures which will be undertaken to reduce spending are streamlining business processes, reducing program activities, and reducing, over time, Canada's contributions to international financial institutions to levels consistent with Canada's international interests and fiscal capacity.

Infrastructure Program

Over the last year, the government successfully launched a \$6-billion program to renew Canada's infrastructure. The Canada Infrastructure Works initiative has been an important element in the government's strategy to foster economic growth and jobs. The program was funded by reallocating \$2 billion of federal funds and it is now well underway. Federal expenditures are expected to peak in 1995-96, declining thereafter as projects come to completion. Because of fiscal pressures, federal expenditures during the planning period will be reduced by \$200 million.

Public Utilities Income Tax Transfer

Under the *Public Utilities Income Tax Transfer Act* (PUITTA), the federal government transfers to provinces and territories a portion of federal corporate income taxes paid by privately owned electric and gas utilities. These payments were intended to "help level the playing field" between privately owned utilities, which pay income taxes, and provincially owned utilities, which do not. However, not all provincial governments pass on the payments to the utilities, and none of the provinces rebates its own provincial income taxes to these utilities.

The federal government can no longer justify making such payments. Therefore, PUITTA transfers in respect of the period after March 31, 1995 will be eliminated. This will reduce expenditures by an estimated $200 million in 1995-96 and $276 million in 1996-97.

Smaller Public Service

Fewer employees will be required in future to deliver government programs. Federal employment, including defence, is expected to decline by about 45,000 or 14 per cent by the time the actions in this budget are fully implemented. Some of the jobs lost in government will be transferred to the private sector, including 6,000 positions in Transport Canada. The reductions will not be distributed evenly across the government.

Federal employment to decline by 45,000

The government understands the value of employment security to its employees and to the quality of the services it delivers to Canadians. In the face of such extraordinary pressures to downsize, however, the government is obliged to consider extraordinary measures.

The President of the Treasury Board has announced the specific measures this government is prepared to take. These measures will allow departments to manage their reductions effectively, while treating fairly employees who must go and those who will stay. These measures include:

- An early retirement incentive for surplus employees in all departments. Surplus employees aged 50 or over with 10 years or more of employment will be able to retire with an immediate pension based on years of service with no penalty for early retirement. It is expected that up to 4,000 employees will take advantage of the incentive. The 15-week separation benefit now available under the Work Force Adjustment Directive (WFAD) to surplus employees eligible for a continuing pension benefit will be eliminated for the duration of the measures.

- A cash-based early departure incentive program comparable to private sector practice which will be made available, for a period of three years, to surplus employees in those departments designated by Treasury Board as "most-affected" because they are unable to meet their reduction through existing workforce adjustment mechanisms. As many as 13,000 to 15,000 employees in the Public Service could take the incentive. The National Defence Civilian

Reduction Program launched in the 1994 budget will be folded into this regime of early departure incentive and its benefit structure will be brought in line on March 31, 1996.

Workforce Adjustment Directive to be changed

■ Certain provisions of the government's current Workforce Adjustment Directive will be suspended for a period of three years, so that surplus employees in the "most affected" departments who decline the departure incentive will cease to be paid after six months and will be laid off one year after that, unless alternative employment is found.

■ Augmented employee transition services, including career counselling and job search assistance, will be provided for employees. Management-labour placement committees will be established in all regions to identify employment opportunities inside and outside the Public Service.

■ Amendments to the *Public Sector Compensation Act* that will allow the Treasury Board to introduce some new voluntary measures such as pre-retirement transition leave without pay and an arrangement whereby employees can take off blocks of time and average their incomes over the year.

■ Amendments to the *Public Sector Compensation Act* to permit changes to non-salary terms and conditions of employment, subject to the constraint of cost-neutrality and without access to binding arbitration or strike. The Treasury Board will also seek to negotiate with unions cost-containment and streamlining of several National Joint Council policies such as Health and Dental Plans and travel directives.

Cost of the cash-based early departure incentives is estimated at this time to be about $1 billion. These costs will be included in the 1994-95 fiscal year as a one-time restructuring charge, consistent with private sector accounting conventions.

The Workforce Adjustment Directive will be changed by legislation for the three-year period to modify restrictions on contracting out and related definition of mobility. These and related changes will facilitate the orderly, cost-effective management of organizational and structural change.

Management staffing flexibilities will be improved through several amendments to the *Public Service Employment Act*, including provisions that will facilitate the block transfer of government functions within the Public Service.

For Crown corporations the government recognizes the competitive market place within which they operate, and their need for greater personnel flexibilities as they strive to address productivity and rationalization gains.

A New Transfer to the Provinces: the Canada Social Transfer

Existing Transfers to Provinces and Territories

The federal government transfers funds to the provinces principally under the following programs (the fiscal dimensions of which are summarized in Table 4.4):

Transfers to provinces to be changed

- *Established Programs Financing (EPF): Health and Post-Secondary Education.* In 1977, federal transfers that formerly had been tied to provincial spending for health and post-secondary education were converted to a "block" transfer, consisting of cash and the value of income tax points given up by the federal government at the time. Although the labels of "health" and "post-secondary education" have been retained, provinces have in

Table 4.4
Major transfer entitlements to provinces

	1993-94	1994-95	1995-96	1996-97	1997-98
			(millions of dollars)		
Current arrangements					
CAP	7,719	7,952	7,952		
EPF-PSE	6,108	6,177	6,251		
EPF-Health	15,128	15,299	15,483		
Total	28,955	29,428	29,686		
Canada Social Transfer				26,900	25,100
Equalization	8,034	8,332	8,870	9,270	9,618
Total major transfer entitlements of which:[1]	36,212	36,974	37,745	35,351	33,889
Tax point transfers[1]	11,290	11,729	12,572	13,248	13,968
Cash transfers	24,922	25,245	25,173	22,103	19,921
Change in entitlements from 1994-95 levels				1,623	3,085

[1] Equalization associated with EPF/CST tax points appears in both Equalization and EPF/CST entitlements. It has been subtracted from "Total major transfer entitlements" and "Tax point transfers" to avoid double counting.

fact been free to spend these transfers according to their own priorities – there is no requirement for the federal EPF transfers to be spent on education, or on health, so long as the principles of the *Canada Health Act* are met.

■ *Canada Assistance Plan (CAP)*: Unlike EPF, the CAP has remained a *cost-shared* program since its inception in 1966. The federal government pays up to one-half of the amount provincial governments spend on a broad range of social services and social assistance for needy Canadians. Program design and delivery are entirely the responsibility of each province. The costs to be shared are determined by provincial decisions subject to federal conditions and rules about eligible costs.

In 1990, the federal government limited the annual growth in CAP transfers to the three better-off provinces – Ontario, British Columbia and Alberta – to 5 per cent per year. The 1994 budget limited 1995-96 CAP transfers to their 1994-95 levels, and stipulated that combined CAP and EPF-PSE entitlements in 1996-97 would be no higher than in 1993-94.

■ *Equalization*: The Equalization program provides unconditional transfers that enable the less well-off provinces to provide Canadians with reasonably comparable levels of public services at reasonably comparable levels of taxation. The program is a pillar of Canadian federalism and a commitment to its principle is enshrined in the Constitution. After consultations with the provinces, the Equalization program was renewed by Parliament for five years beginning 1994-95. No changes are proposed in this budget.

The government has told the provinces that it will make no changes in the nature and amount of any of these major transfers in 1995-96, beyond the measures already announced in the 1994 budget. Accordingly in 1995-96, EPF transfers will grow in line with the current formula while CAP transfers will be limited to their 1994-95 levels. As a result, combined EPF and CAP transfers will grow to $29.7 billion in 1995-96 from $29.4 billion in 1994-95.

The Canada Social Transfer

Block Funding of programs in areas of provincial responsibility

Effective 1996-97, the major transfers to the provinces under CAP and EPF will be structured differently to create a system that is both better suited to contemporary needs and fiscally sustainable.

It is now time to complete the gradual evolution away from cost-sharing to block funding of programs in areas of provincial

responsibility. This will be done by replacing EPF and CAP by a new block grant – the Canada Social Transfer (CST).

The new transfer will end the intrusiveness of cost-sharing under CAP and will reduce the federal-provincial entanglement that has been a source of irritation with current cost-shared transfer arrangements.

- Federal expenditures will no longer be driven by provincial decisions on how, and to whom, to provide social assistance and social services.
- Provinces will no longer be subject to rules stipulating that certain expenditures are eligible for cost-sharing and others are not. Provinces will thereby be free to pursue innovative approaches to social security reform without having to consider whether such approaches meet requirements for cost-sharing.
- The expense to both federal and provincial governments of administering cost-sharing will be eliminated.

Similar considerations led the Standing Committee on Human Resources Development, in its recent report on social security reform (February 6, 1995), to recommend the conversion of CAP to a block fund.

Canada Health Act will continue to be enforced

Although provinces will be able to spend the transferred resources on priorities of their own choosing, the transfer will *not* be totally unconditional. No change will be made to the *Canada Health Act*. The government will continue to enforce it by withholding funds, if necessary. Provinces will also be required, as they are now under the rules of CAP, to provide social assistance without any minimum residency requirements on social assistance applicants.

Furthermore, the federal government, under the leadership of the Minister of Human Resources Development, will invite all provincial governments to work together on developing, through mutual consent, a set of shared principles and objectives that could underlie the new transfer. In this way, all governments could reaffirm their commitment to the social well-being of Canadians.

As is currently the case with both EPF and CAP, the new transfer will be a combination of cash and tax points. In 1996-97, total funding to provinces under the new transfer will be $26.9 billion, a reduction of $2.5 billion compared with the projected transfer entitlement under the existing set of programs. In 1997-98, funding will be reduced further to $25.1 billion, a cut of $4.5 billion

from the currently projected transfer under existing programs. The latter reduction is equivalent to about 3 per cent of aggregate provincial government revenue.

The federal government will continue to transfer large amounts of money to the provinces after these reforms, providing individual provinces with amounts varying from about 20 per cent to over 40 per cent of their total revenues. Table 4.4 shows that major transfer entitlements to the provinces – Equalization plus the new CST – will total $35.4 billion in 1996-97 and $33.9 billion in 1997-98.

The reduction in major transfers to the provinces is less than the cuts in other areas of federal program spending. The reduction in transfers to provinces in 1996-97 compared to 1994-95 is 4.4 per cent. Over the same years, the reduction in total federal spending apart from the transfers to provinces is 7.3 per cent (excluding restructuring charges in 1994-95).

To enable provinces to develop fiscal plans with some certainty for 1996-97, CST transfers will be allocated among provinces that year in the same proportion as provincial entitlements under combined CAP and EPF transfers in 1995-96. The federal government will consult with provinces on the principles that should govern allocation of the CST on a permanent basis thereafter.

Territorial Formula Financing

Territorial Formula Financing is the principal means by which the federal government provides funds to the governments of the Northwest Territories and Yukon. This funding is governed by agreements with the territorial governments, which will be renewed for four years beginning April 1, 1995. Territorial Formula Financing has not previously been subject to federal budgetary restraint, but in view of fiscal requirements the following reductions will be made:

- entitlements for each territory in 1995-96 will be frozen at 1994-95 levels; and
- the 1996-97 Gross Expenditure Base in the Formula will be reduced by 5 per cent for each territory.

These measures will secure savings of an estimated $14 million in 1995-96, $79 million in 1996-97 and $81 million in 1997-98, without compromising the basic structure and operation of Formula Financing.

Fiscal Stabilization Program

Threshold restored for Stabilization program

The Fiscal Stabilization Program was introduced in 1967. Originally it provided federal compensation to a province if economic conditions caused its revenues to decline by more than 5 per cent from one year to the next – that is, in the event of a severe economic downturn. The program was amended in 1972 to provide compensation if a province's revenues fell at all. While only two payments were made under the program between 1967 and 1990, the combination of the last recession and falling inflation has caused some provinces' revenues to decline on several occasions since then. This has triggered recent Stabilization payments to virtually all provinces.

Now that inflation is low and stable, even a minor economic downturn can result in a decline in a province's revenues and thus result in a Stabilization payment. This is not consistent with the intent of the program, nor with current fiscal circumstances. Accordingly, the threshold condition for eligibility for stabilization payments is being restored to that which prevailed between 1967 and 1972 – that is, a year-over-year revenue decline exceeding 5 per cent. This threshold will apply to claims in respect of 1995-96 and subsequent years.

The federal government will thus continue to play a role in stabilizing revenues of provincial governments, but only in times of severe economic shocks, as was originally intended when the program was introduced. There are no immediate savings associated with this measure.

Unemployment Insurance Reform

Unemployment insurance will remain an essential component of Canada's social safety net. As presently designed, however, unemployment insurance undermines the employability of Canadians and often discourages adjustment to changing economic conditions. It has led many individuals and some industries and regions to become dependent on this type of income support. At the same time, the cost of financing the program has added significantly to payroll taxes, which discourage new hiring, particularly in lower-wage jobs.

Building on measures in the 1994 budget, the Minister of Human Resources Development intends to table legislation this fall to make further changes to unemployment insurance. Funds will be channelled from those aspects of the benefit structure that create dependence and stifle the economic energy of the country to

Unemployment insurance program to be reduced by 10 per cent

investments in people to make them more employable. Canada's strong economic performance and unemployment insurance reform – which the government intends to have in place no later than July 1, 1996 – will reduce the overall size of the unemployment insurance program by a minimum of 10 per cent. This overall reform, combined with the improvements in the administration of the unemployment insurance program referred to above, will secure savings for taxpayers of $700 million in 1996-97.

Reform will be designed and carried out in a manner that eases the transitional impact of changes in provinces where there is a history of reliance on unemployment insurance.

Improved employment conditions are rapidly eliminating the deficit in the unemployment insurance account which had reached almost $6 billion in 1993. With no increase in premium rates, the cumulative surplus in the Unemployment Insurance Account will be allowed to rise to above $5 billion through to the end of 1996. This surplus will be maintained and used as a buffer to mitigate unemployment insurance premium rate increases during periods of slowing economic growth.

The result of these measures will be a unemployment insurance program that does a much better job of investing in people, and lower, more stable unemployment insurance premium rates that encourage the creation of jobs.

The Retirement Income System

Canada's population is ageing. As Canadians live longer and birth rates remain low, the percentage of persons over age 65 will nearly double over the next 40 years – from 12 per cent of the population today to about 23 per cent by the year 2030.

As a result, Canada will have only three workers in the next century to support every retired person, compared to five now. Expenditures on Old Age Security (OAS) and the Canada and Quebec Pension Plans, which have been rising steadily, will continue to increase significantly as a share of the economy over the next 40 years – from 5.3 per cent in 1993 to more than 8 per cent in 2030.

Canadians have expressed concerns that the rising costs of our public pension system are placing their pensions at risk.

This budget begins action to put Canada's retirement income system on a fairer and sustainable basis. The first part of this system – tax assistance for private pensions – is being modified to conform to a key principle of pension reform. This is dealt with in the following section on a fairer tax system.

Canada Pension Plan

Review of Canada Pension Plan ... reform of elderly benefits

The second part of the retirement income system – the Canada Pension Plan – will be addressed this fall when the finance ministers of Canada and the provinces meet to conduct their regular five-year review of the financing of the CPP.

CPP pensions are paid entirely by contributions made by employers and employees, and are based on past earnings. As such, CPP retirement pensions, quite rightly, are not subject to income testing. They are the base on which all Canadians, whatever their earnings, can build their retirement income.

The federal-provincial review of the CPP will be based on the actuarial report on the CPP recently tabled in Parliament. This report concludes that CPP benefits will cost significantly more than previously expected because of the effects of the last recession and higher numbers of persons receiving disability benefits. Both future contribution rates and the cost of benefits will therefore be examined carefully in this year's review of the Canada Pension Plan.

Old Age Security and Guaranteed Income Supplement

The government believes that it is equally important to ensure the sustainability of the other pillar of the public pension system – Old Age Security (OAS) and the Guaranteed Income Supplement (GIS). These benefits today cost over $20 billion, a cost that is estimated to grow by 60 per cent over the next 15 years as the population ages.

The Minister of Human Resources Development, in collaboration with the Minister of Finance, will release a paper later this year on the changes required in the public pension system to ensure its

affordability with the goal of legislating changes to take effect in 1997. The basic principles for reforming OAS and GIS shall be:

- undiminished protection for all seniors who are less well-off, including, of course, all those now receiving the Guaranteed Income Supplement;
- a continuation of full indexation of benefits to protect seniors from inflation;
- the provision of OAS benefits on the basis of family income, as is currently the case with the Guaranteed Income Supplement;
- greater progressivity of benefits by income level; and
- control of program costs.

Consultations with seniors, and with Canadians generally, on the precise nature of needed changes will take place when the paper is released later this year. In the interim, two changes are proposed to the way OAS is currently recovered from high-income persons.

- At present, full OAS benefits are paid out to individuals regardless of income, and then taken back at tax filing time from individuals with incomes of more than $53,215. Effective July 1996, OAS benefits will be calculated and paid out net of the high-income recovery amounts. The correct amount of payments will be automatically determined based on a person's income as reported on their prior year's tax return.

This measure will not affect the net benefits provided to seniors because the income testing of OAS will be done prior to payments being made. There will be one-time savings to the federal government of about $200 million in 1996-97 and about $100 million in 1997-98.

- Effective July 1, 1996 OAS recipients who are no longer resident in Canada will have to file a statement of their world-wide income in order to continue to receive OAS benefits. Currently, non-residents with incomes above $53,215 escape the high-income recovery. They are treated more favourably than residents of Canada.

A Fairer Tax System – Sharing the Burden of Deficit Reduction

The government is aware of the heavy tax burden already borne by Canadians and the costs this imposes on the economy as a whole. Accordingly, federal personal income tax rates are not being raised.

Tax measures are largely directed at removing preferences and increasing fairness. However, to help meet the deficit targets, this budget announces increases in taxes on businesses and an increase of 1.5 cents per litre in the excise tax on gasoline.

Overall, tax measures account for $3.7 billion of the $29.0 billion of total budget actions over the next three years. There is seven dollars of cumulative expenditure reduction for every dollar of new taxes over the three-year period.

Details of all Tax Measures are contained in Annex 6: Tax Measures – Supplementary Information.

Increasing Fairness and Tightening the Tax System

Improving Fairness in Tax-Assisted Retirement Saving

This budget proposes actions to bring the rules of the private component of the retirement system in line with a key principle of pension reform. The principle is that tax assistance should be provided for contributions to registered savings plans based on earnings up to two-and-one half times the average wage, and no more.

Contribution limits to be reduced

Reduce RRSP and money purchase pension plan limits: The dollar limit on deductible RRSP contributions will be reduced to $13,500 for 1996 and 1997 and then will be increased by $1,000 a year to reach $15,500 in 1999. The dollar limit on contributions to money purchase pension plans will also be reduced to $13,500 in 1996. This limit then will be increased by $1,000 a year to reach $15,500 in 1998. The dollar limits on contributions to deferred profit sharing plans (DPSPs) will continue to be one-half the contribution limits for money purchase pension plans. The maximum pension limit for defined benefit pension plans will be frozen at its current level through 1998. The pension and DPSP limits will be indexed beginning in 1999 and the RRSP limit in 2000.

The government will investigate the possibility of modifying the RRSP limits, without incurring additional revenue costs, to restore lost RRSP room to employees who leave pension plans before retirement.

Reduce RRSP overcontribution allowance: A penalty tax of less 1 per cent applies to excess RRSP contributions above a margin of $8,000. Beginning in 1996, this overcontribution allowance will be reduced from $8,000 to $2,000.

Phase-out retiring allowance rollovers: Individuals are permitted to transfer to an RRSP up to $2,000 per year of service out of a retiring allowance. This rollover will be phased out by reducing the limit to zero for years of service after 1995.

Payout of locked-in registered retirement savings plans: The government will amend the *Pension Benefits Standards Act* to allow the holders of locked-in RRSPs to purchase Life Income Funds, a more flexible way of managing retirement income funds. The holders of locked-in RRSPs now can only purchase life annuities with these funds.

Strengthen Revenue Canada's Ability to Enforce the Law

Increased enforcement by Revenue Canada

A number of measures will be taken to improve the ability of Revenue Canada to enforce the tax laws. These will ensure that everyone pays a fair share of tax and that legitimate businesses are not subject to unfair competition from those evading taxes. In particular:

- New rules will require contractors in the construction industry to report payments made to subcontractors.
- New expanded reporting requirements will be introduced for foreign trusts and other foreign investments.
- Revenue Canada will strengthen its ability to audit large corporations. This will include creating teams of specialists to handle complex audits.
- Revenue Canada's ability to obtain court orders requiring the production of information required to verify compliance with the law will be strengthened.
- New rules will be introduced to provide that where a person interferes with the remittance of source deductions and GST, that person will have the same liability as the taxpayer for the payment of those amounts, together with any interest and penalties.

Additional Tax on investment Income of Private Corporations

Effective July 1, 1995, a refundable tax will be levied on the investment income received by a Canadian-controlled private corporation. This tax will reduce the current deferral advantage to individuals earning investment income through these private corporations instead of earning such income directly. The deferral advantage arises when the corporate tax rate applied to this income is lower than the marginal tax rate of the individual shareholder.

Eliminate Deferral of Tax on Business Income

Individuals who earn business or professional income now have the option to choose any date as their fiscal year-end for reporting income from these activities. As a result, these businesses can delay the reporting of income and consequently delay the payment of tax on an ongoing basis. Effective for taxation years starting after 1994, these taxpayers will be required to report their business or professional income on a calendar year basis. In recognition of the fact that this change could result in a very large one-time tax increase for many of these taxpayers, the measure includes transitional provisions to bring this additional amount into income over a 10-year period.

Restrict SR&ED Tax Incentives

Concerns have arisen with respect to the treatment of information technology R&D expenditures generally, and in particular, those incurred by financial institutions. The Department of Finance and Revenue Canada are undertaking a thorough evaluation of the Scientific Research and Experimental Development (SR&ED) tax incentives. However, in light of these concerns, the Departments will accelerate the component of the evaluation dealing with the eligibility of work performed in the area of information technology R&D.

Furthermore, as an interim measure, all information technology R&D performed after budget day by financial institutions will be excluded from the definition of SR&ED, pending the completion of the review of information technology R&D.

The budget also proposes a number of technical changes to the SR&ED tax incentives in the areas of contract R&D, third-party payments and unpaid amounts. These changes follow consultations with the industry and will make the system fairer and improve the government's ability to monitor this tax incentive.

Family Trusts

The budget proposes two changes to the taxation of family trusts. First, the existing election to defer the application of the 21-year rule will be eliminated January 1, 1999. Second, to restrict income splitting, the preferred beneficiary election mechanism will be repealed for taxation years of trusts that commence after 1995, except for elections in respect of persons with mental or physical disabilities.

Re-Targeted Film Incentive

The budget proposes to re-target government assistance available to certified Canadian film productions in order to maximize the benefit to such productions. The current tax incentive for films provides a tax shelter used principally by higher-income individuals. The new mechanism will take the form of a refundable investment tax credit of 25 per cent of the cost of eligible salaries and wages. Eligible salaries and wages are limited to 48 per cent of the cost of the production – thus the new credit will provide assistance of up to 12 per cent of the cost of an eligible production. The new mechanism will be in place for the 1995 year, running parallel with the existing capital cost allowance (CCA) incentive. Producers will have a choice of either system for 1995 but not both. The CCA incentive system for film production will be eliminated for films acquired after 1995.

Measures Limiting the Use of Tax Shelters

In order to stem the tax leakage resulting from the marketing of aggressive tax shelters, the government took immediate steps on December 1, 1994 to improve the fairness of the tax system and prevent abuse. The measures affect limited recourse financing, extend the base upon which the alternative minimum tax is calculated, modify the tax shelter identification rules and increase reviews and audits of tax shelters. This will ensure that the tax base is protected and only legitimate expenses are deductible.

Resource Allowance Review

Petroleum and mining companies are allowed to deduct a "resource allowance" in calculating income taxes. This resource allowance deduction has been in place since 1976 and was introduced in lieu of allowing deductions for Crown royalties and mining taxes. Concerns have been raised that the current rules may not be working as originally intended. The government will be consulting with the provinces and the affected industries to identify possible improvements to or replacement mechanisms for the resource allowance.

Increases in Corporate Tax Rates

Increase in the Large Corporations Tax Rate

The rate of the large corporations tax will rise by 12.5 per cent – from 0.2 per cent to 0.225 per cent of capital used in Canada in excess of $10 million – effective immediately.

Increase in the Corporate Surtax

The corporate surtax, currently levied at a rate of 3 per cent of the basic federal corporate income tax, will be increased to 4 per cent – effective immediately.

Temporary Capital Tax Increase for Large Deposit-Taking Institutions

The capital tax imposed on banks and other large deposit-taking institutions will be increased on a temporary basis. This increase effective immediately, will be in effect until October 31, 1996, and will raise approximately $100 million.

Excise Tax Increases

Increased Excise Tax Rates on Tobacco Products

Under the National Action Plan on Smuggling announced February 8, 1994, excise tax rates on tobacco products were reduced by $5 across the country with additional matching reductions up to a maximum of $10 where provincial governments chose to undertake further reductions. As a result, there has been a dramatic decline in contraband activity and a significant restoration of the domestic tobacco market to legitimate Canadian wholesalers

Table 4.5

Total direct impact of tax measures

	1995-96	1996-97	1997-98
	(millions of dollars)		
Measures to increase fairness and tighten the tax system			
Improving fairness in tax-assisted retirement saving	15	95	160
Strengthen Revenue Canada's ability to enforce the law	Prevents revenue losses		
Additional tax on investment income of private corporations	40	120	120
Eliminate deferral of tax on business income	–	170	300
Restrict SR&ED tax incentives	–	15	15
Family trusts	Prevents revenue losses		
Retargeted film incentive	small	small	small
Subtotal	55	400	595
Increases in tax rates			
Corporate			
Large corporations tax	145	155	160
Corporate surtax	115	115	120
Temporary capital tax increase for large deposit-taking institutions	60	40	-
Excise			
Tobacco	65	65	65
Gasoline	500	500	500
Subtotal	885	875	845
Total	940	1275	1440

and retailers. Moving toward re-establishment of a uniform federal excise tax rate on tobacco products, the federal excise tax rates on cigarettes sold for consumption in Quebec and Ontario, the two provinces that undertook the deepest tax reductions one year ago, were increased by 60 cents per carton of 200 cigarettes as of February 18, 1995. This measure will raise $65 million annually.

Increase Excise Tax on Gasoline

The federal excise tax on leaded and unleaded gasoline and aviation gasoline will be increased by 1.5 cents per litre effective midnight tonight. The increase will raise approximately $500 million in additional annual revenues. This will restore total revenue from all federal excise taxes to approximately their level in 1993-94.

Summary of Fiscal Savings

Fiscal actions in this budget total $29.0 billion over the three fiscal years 1995-96 through 1997-98 (Table 4.6). This is the largest set of fiscal actions of any budget since postwar demobilization. The 1989 budget contained the second largest set, but three-quarters of the $24 billion in three-year savings in that budget came from increased revenues. The February 1994 budget contained $20.4 billion in net savings over three years with five-sixths of the action coming from lower spending.

In this budget, fiscal savings also come overwhelmingly from expenditure reductions. Over the period 1995-96 to 1997-98 expenditure savings will exceed revenue increases by a ratio of nearly seven to one.

Spending cuts exceed tax revenue increases by a ratio of seven to one

Expenditure reductions due specifically to actions in this budget total $4.1 billion in 1995-96, $9.3 billion in 1996-97, and $11.9 billion in 1997-98. The expenditure cuts fall primarily on federal government operations, rather than transfers to provinces or to households. Most of the savings in 1995-96 and more than half the savings in the next two years, come from the government's Program Review, demonstrating that the government's priority has been to get its own house in order first.

Table 4.6
Total direct impact of budget measures

	1995-96	1996-97	1997-98	3-year[1] impact
	(billions of dollars)			
Expenditure reductions				
Program review	3.9	5.9	7.2	16.9
Other	0.2	3.5	4.7	8.4
Total	4.1	9.3	11.9	25.3
Revenue measures				
Increase fairness and tighten tax system	0.1	0.4	0.6	1.1
Tax increases	0.9	0.9	0.8	2.6
Total	0.9	1.3	1.4	3.7
Total direct impact of fiscal actions	5.0	10.6	13.3	29.0
Ratio of expenditure reductions/ tax revenue increases	4.4:1	7.3:1	8.3:1	6.9:1

[1] Three-year cumulative impact of deficit reductions shows the reduction in net debt, by the end of the 1997-98 fiscal year, arising from fiscal actions.

Numbers may not add due to rounding.

5

The fiscal outlook

Deficit Below Target in 1994-95

Underlying deficit for 1994-95 $4.4 billion below target

The underlying deficit for 1994-95 is projected to be $35.3 billion, $4.4 billion lower than the estimate of $39.7 billion in the February 1994 budget (see Chapter 3). Measures taken in this budget have given rise to one-time restructuring charges totalling $2.6 billion associated with personnel reductions and the elimination of the subsidies under the *Western Grain Transportation Act*. Under the accounting policies followed by the government, such charges must be recognized in the year in which the policy decision is made. This is consistent with the approach followed in last year's budget, when one-time restructuring costs announced in that budget were charged to the 1993-94 deficit.

Thus, the reported deficit for 1994-95 is expected to be $37.9 billion, $1.8 billion below the level forecast in last year's budget (Table 5.1).

The Fiscal Outlook: An Overview

Policy actions offset impact of higher interest rates

The policy actions in this budget offset the impact of the higher interest rates on the deficit, so that the interim deficit targets set out in the 1994 budget *will be met*. The deficit will be reduced to $32.7 billion in 1995-96 and to 3 per cent of GDP or $24.3 billion in 1996-97.

Table 5.1
The fiscal outlook – summary
Includes impact of budget measures

	1994-95	1995-96	1996-97
	(billions of dollars)		
February 1994 budget deficit targets	39.7	32.7	–
Impact of economic factors	-4.4	5.0	–
Status quo deficit	35.3	37.7	34.9
Restructuring charge	2.6	–	–
Impact of actions to reduce deficit	–	-5.0	-10.6
February 1995 budget deficit	37.9	32.7	24.3

These projections include a contingency reserve of $2.5 billion for 1995-96 and $3.0 billion for 1996-97. These provide a cushion against adverse changes in the economy beyond the already prudent economic assumptions underlying the status quo deficit projections. To the extent that these reserves are not needed, the deficit will be correspondingly lower.

The contingency reserve

The contingency reserve is included in the deficit projection primarily to cover risks arising from (i) unavoidable inaccuracies in the models used to translate economic assumptions into detailed budget forecasts, and (ii) unpredictable events. The contingency reserve also provides an extra measure of back-up against adverse errors in the economic forecast. **The contingency reserve is not a source of funding for new policy initiatives.**

Table 5.2
Summary statement of transactions:
Fiscal outlook with budget measures

	1993-94	1994-95	1995-96	1996-97
	(billions of dollars)			
Budgetary transactions				
Budgetary revenues	116.0	125.0	133.2	137.4
Program spending	-120.0	-118.3	-114.0	-107.9
Operating balance	-4.0	6.7	19.2	29.4
Public debt charges	-38.0	-42.0	-49.5	-50.7
Underlying deficit	-42.0	-35.3	-30.2	-21.3
Restructuring charges		-2.6		
Contingency reserve			-2.5	-3.0
Deficit	-42.0	-37.9	-32.7	-24.3
Non-budgetary transactions	12.2	11.9	7.8	10.6
Financial requirements (excl. foreign exchange transactions)	-29.8	-26.0	-24.9	-13.7
Net public debt	508.2	546.1	578.8	603.1
Gross domestic product	711.7	746.4	787.1	821.3
Percentage of GDP				
Budgetary revenues	16.3	16.7	16.9	16.7
Program spending[1]	16.9	16.2	14.5	13.1
Public debt charges	5.3	5.6	6.3	6.2
Deficit	-5.9	-5.1	-4.2	-3.0
Financial requirements	-4.2	-3.5	-3.2	-1.7
Net public debt	71.4	73.2	73.5	73.4

[1] Includes restructuring charges.

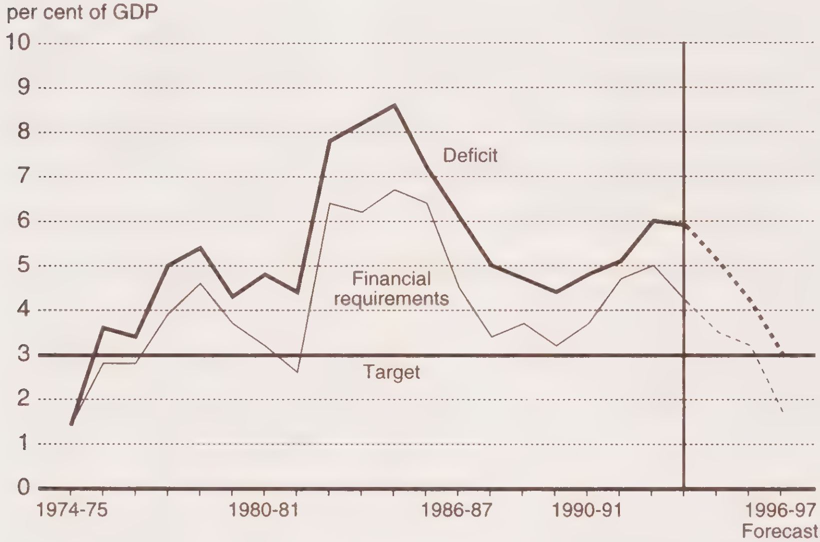
Notes: (-) indicates a net requirement for funds.
(+) indicates a source of funds.
Numbers may not add due to rounding.

As a result of the actions in this budget:

- The deficit falls to 3 per cent of GDP in 1996-97, the lowest ratio since 1974-75 (Chart 5.1).

Chart 5.1

Public accounts deficit and financial requirements



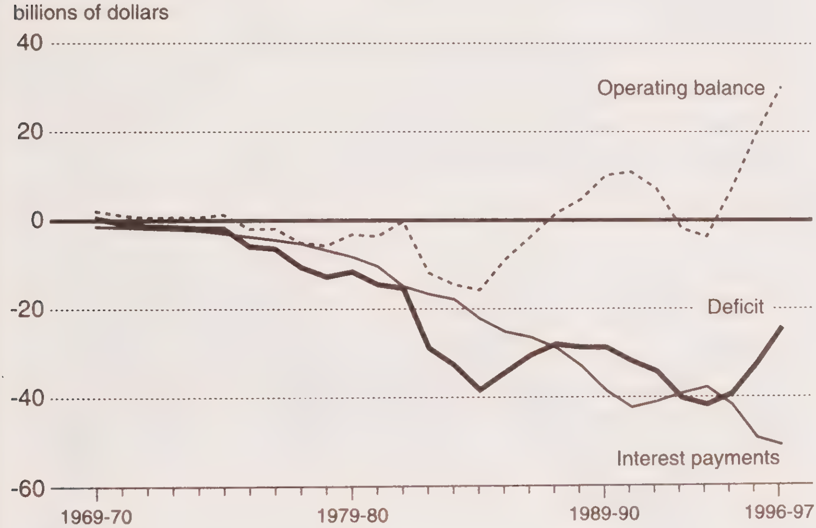
- Financial requirements – a measure of required net new borrowing on credit markets – will decline sharply, from $29.8 billion in 1993-94 to $13.7 billion in 1996-97 (Table 5.2). This represents 1.7 per cent of GDP, the lowest requirements since 1973-74.
- Financial requirements are a more comparable measure of the government's fiscal position on an international basis, in particular with respect to the United States. On this basis, Canada's fiscal performance in 1996-97 will be significantly better than in the United States (Annex 4).

■ The operating balance – the difference between budgetary revenues and program spending – will swing from a deficit of $4.0 billion in 1993-94 to a surplus of $29.4 billion in 1996-97.

■ The operating surplus in 1996-97 represents 3.6 per cent of GDP – the largest such surplus since 1951-52.

Chart 5.2

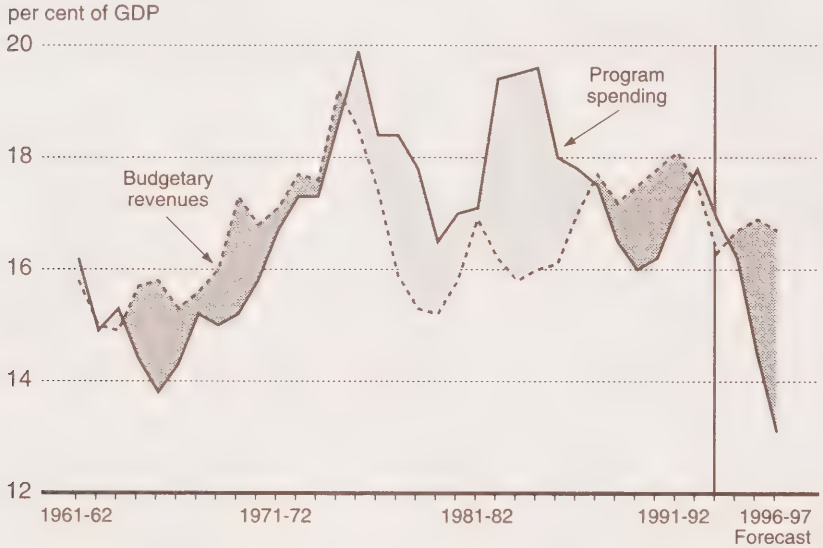
The evolution of the federal deficit



- The dramatic turnaround in the operating balance is attributable to the control on program spending.
- As a percentage of GDP, program spending will decline rapidly over the forecast period, primarily due to the fiscal actions taken in this and last year's budgets.
- By 1996-97, the ratio of program spending to GDP is expected to fall to 13.1 per cent, the lowest ratio since 1950-51.
- In contrast, budgetary revenues, as a percentage of GDP, recover only marginally and are below the pre-1990-91 recession percentages.

Chart 5.3

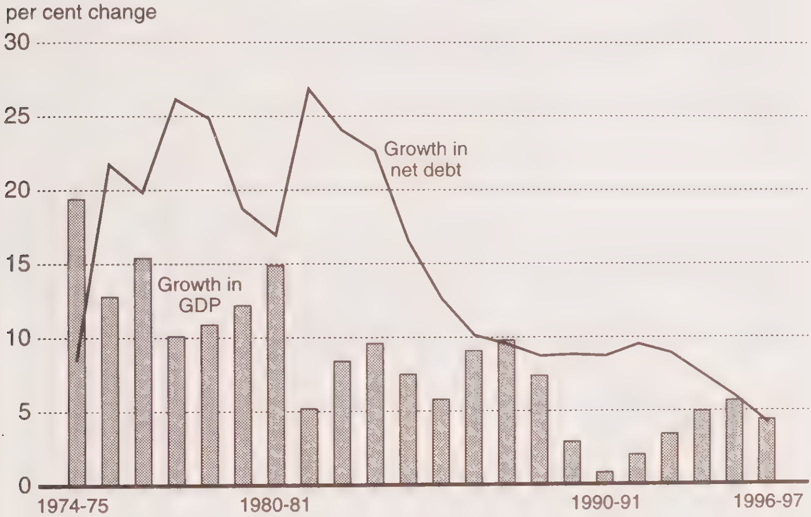
Program spending and budgetary revenues



■ With the actions in this budget, the rate of growth in net public debt – the cumulation of deficits and surpluses since confederation – slows significantly. By 1996-97, it grows at a rate less than the rate of growth in the economy.

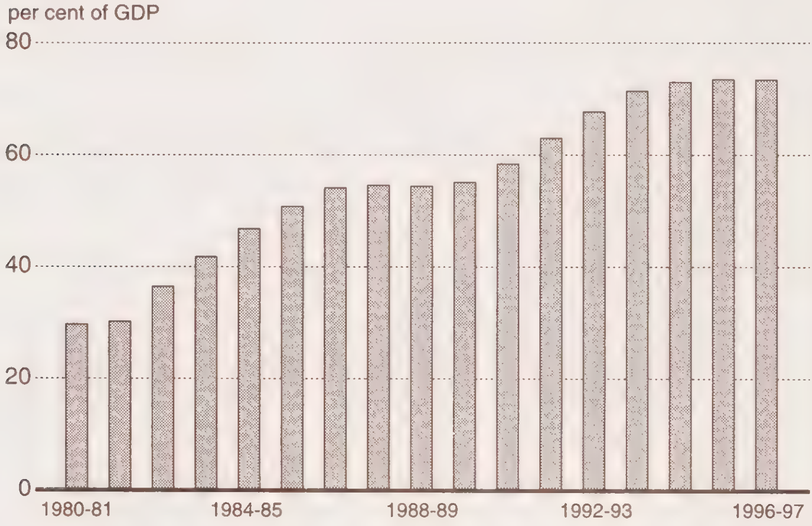
Chart 5.4

Growth in federal net debt and GDP



- With the rate of growth in net public debt projected to be less than the growth in nominal GDP by 1996-97, the debt-to-GDP ratio begins to decline.
- The debt-to-GDP ratio is expected to fall at a more pronounced pace after 1996-97 in response to the permanent spending reductions in this budget.

Chart 5.5
Federal government net debt



- Fiscal actions in this budget amount to $5.0 billion in 1995-96, $10.6 billion in 1996-97, and $13.3 billion in 1997-98.
- By the end of 1997-98, the direct fiscal actions in this budget will have reduced net public debt by $29.0 billion from what it would otherwise have been.
- Over the three years, expenditures are cut by a cumulative $25.3 billion. On an annual basis, cuts will be $11.9 billion in 1997-98.
- Over the three year period, there are seven dollars of spending cuts for each dollar of taxation increases.
- Over half of the fiscal savings result directly from the Program Review exercise.

Table 5.3
Total direct impact of budget measures

	1995-96	1996-97	1997-98	3-year[1] impact
		(billions of dollars)		
Expenditure reductions				
Program review	3.9	5.9	7.2	16.9
Other	0.2	3.5	4.7	8.4
Total	4.1	9.3	11.9	25.3
Tax measures				
Increase fairness and tighten tax system	0.1	0.4	0.6	1.1
Tax increases	0.9	0.9	0.8	2.6
Total	0.9	1.3	1.4	3.7
Total direct impact of fiscal actions	5.0	10.6	13.3	29.0
Ratio of expenditure reductions/ tax revenue increases	4.4:1	7.3:1	8.3:1	6.9:1

[1] Three-year cumulative impact of deficit reductions shows the direct reduction in net debt, by the end of the 1997-98 fiscal year, arising from fiscal actions.

Fiscal Outlook: Sensitivity to Economic Assumptions

Estimates of the main fiscal aggregates are sensitive to changes in economic assumptions – particularly the level of nominal income and interest rates. The following sensitivity estimates are intended only to capture the direct fiscal impacts of changes in one economic variable at a time. These are static calculations. For example, in the nominal income sensitivity estimate, there is no feed-through of the change in nominal income to other variables, such as interest rates and unemployment.

Sensitivity to Changes in Nominal Income

A 1-per-cent increase in the level of nominal income leads to higher tax bases and therefore higher revenues. Expenditures are lower, primarily due to lower interest costs since the stock of debt is smaller than it otherwise would be.

The deficit impact would depend on the source(s) of the increase in nominal incomes. The most favourable impact on the fiscal situation would occur if all of the increase in nominal income was due to an improvement in productivity. Inflation and interest rates would not rise and indeed could decline. Revenues would be higher and borrowing costs lower.

If, however, the improvement was solely due to inflation, then some of the positive impact on government revenues would be offset by higher spending on those programs that are indexed to inflation. In addition, higher nominal GDP, caused either through higher inflation or stronger demand in the economy, would likely raise interest rates, thereby increasing public debt charges.

Table 5.4
Fiscal sensitivity analysis: 1-per-cent increase in nominal income

	Estimated changes to fiscal position			
	Year 1	Year 2	Year 3	Year 4
	(billions of dollars)			
Budgetary transactions				
Revenue increases	1.2	1.3	1.4	1.6
Expenditure reductions	0.1	0.2	0.1	0.1
Deficit reduction	1.3	1.5	1.5	1.7

Assuming the increase in nominal incomes comes solely from an increase in real output, the deficit would be lowered by $1.3 billion in the first year, rising to $1.7 billion after four years, as saving from lower debt charges begin to accumulate.

Sensitivity to Changes in Interest Rates

In contrast to the uncertainties of the sensitivity of the deficit to changes in nominal GDP, the impact of interest rate changes on public debt charges can be calculated with considerable precision. A sustained 100-basis-point decline in all interest rates causes the deficit to decline by about $1.8 billion in the first year. This is greater than the $1.7 billion sensitivity stated in both the 1994 budget and the October Update reflecting the growth of public debt. As longer-term debt matures and is refinanced at the lower interest rate, the favourable impact on the deficit increases, such that by year four, the deficit is about $3.6 billion lower.

A sustained 1 per cent decline in interest rates reduces the deficit by $1.8 billion in the first year

Table 5.5
Fiscal sensitivity analysis:
100-basis-point decline in all interest rates

	Estimated changes to fiscal position			
	Year 1	Year 2	Year 3	Year 4
	(billions of dollars)			
Budgetary transactions				
Revenue decrease	0.3	0.3	0.4	0.4
Expenditure reductions	2.1	2.9	3.5	4.0
Deficit reduction	1.8	2.6	3.1	3.6

Implications of Sensitivities for the Fiscal Outlook

Sensitivities and the Contingency Reserve

The foregoing imply that the deficit target would be met next year even if interest rates were 100 basis points higher, and real growth one-half percentage point lower. This is because the contingency reserve of $2.5 billion is large enough to handle adverse economic developments of this magnitude.

Sensitivities and the Private Sector Forecasts

Conversely, the deficit would be well below the targets if interest rates were lower and real growth higher than assumed, e.g., if interest rates and real growth in 1995 and 1996 were in line with the average of the private sector forecasts.

Deficit based on private sector average is much lower

For 1995-96, the deficit could be as much as $3.8 billion lower than projected in the budget. This is because the interest rate assumptions in the budget for 1995 are about 70 basis points higher that the average of the private sector forecasts and the contingency reserve of $2.5 billion in 1995-96 would not be required.

The deficit, in 1996-97, could be below $19 billion, i.e. $5.5 billion less than forecast in the budget. The budget assumes interest rates about 60 basis points higher and nominal incomes about $6 billion lower than the private sector average forecasts. If the private sector average outcome were realized, the contingency reserve of $3.0 billion in that year would not be required. In this scenario, financial requirements would fall to about $8 billion in 1996-97, or 1 per cent of GDP. The debt-to-GDP ratio would decline from 73.2 per cent in 1994-95 to under 72 per cent in 1996-97.

Table 5.6
Fiscal sensitivities

	1995-96		1996-97	
	Budget	Private sector average[1]	Budget	Private sector average[1]
Deficit				
$ billions	32.7	28.9	24.3	18.8
Per cent of GDP	4.2	3.7	3.0	2.3
Financial requirements				
$ billions	24.9	21.1	13.7	8.2
Per cent of GDP	3.2	2.7	1.7	1.0
Net public debt				
$ billions	578.8	575.0	603.1	593.9
Per cent of GDP	73.5	73.1	73.4	71.8

[1] Adjusting the budget fiscal outlook to the average of private sector economic assumptions and assuming the contingency reserves are not required.

Implication for Fiscal Outlook in 1997-98

The sensitivity of the fiscal projections to economic developments increases as the forecast period is extended.

Given these uncertainties, the budget does not contain fiscal projections beyond 1996-97. A perspective of the fiscal prospects and deficit target for 1997-98 will be provided in the 1996 budget.

However, a simple extrapolation to 1997 of the economic assumptions contained in Chapter 2, coupled with the impact of the fiscal actions announced in this budget, can provide some insight into the deficit outlook beyond 1996-97.

The fiscal outlook for 1997-98 will be largely determined by the following factors:

- the impact of the incremental savings generated from the actions proposed in this budget;
- the interest rate outlook for 1997; and
- the economic growth outlook for 1997.

Fiscal savings will continue to grow

Fiscal savings of $13.3 billion in 1997-98 will be realized as a result of the actions proposed in this budget. This is an increase of $2.7 billion from the measures proposed for 1996-97. With $2.6 billion of these incremental savings affecting program spending, program spending will continue to decline in 1997-98.

Table 5.7
Fiscal savings

	1995-96	1996-97	1997-98
		(billions of dollars)	
Expenditure reductions/ management initiatives	4.1	9.3	11.9
Taxation measures	0.9	1.3	1.4
Total	5.0	10.6	13.3

Assuming that nominal income would increase at even the same modest rate as projected for 1996, budgetary revenues will be higher in 1997-98 than in 1996-97. As a result of lower program spending and higher revenues, the operating surplus will increase further in 1997-98.

Deficit in 1997-98 will continue to fall

As discussed in Chapter 2, interest rates are expected to be lower in 1996 than in 1995. Even if interest rates were to remain at their 1996 levels in 1997, the average effective interest rate on the public debt would continue to fall. This decline in the average effective interest rate should be sufficient to offset the impact on the deficit of the new borrowing requirements for 1997-98.

With an increased operating balance and little change in public debt charges, the deficit and debt-to-GDP ratio will continue to decline.

The Revenue Outlook

The revenue outlook to 1996-97 is summarized in Table 5.8.

Revenue up sharply in 1994-95

Budgetary revenues are expected to have increased $9.0 billion in 1994-95, or 7.8 per cent. Personal income tax – the largest source of federal revenues – rose by $5.7 billion, or 11.1 per cent, accounting for nearly two-thirds of the increase in total budgetary revenues. However, over half the gain in personal income tax revenues was due to special factors including:

- the faster processing of tax returns in March 1994;
- transitional costs in 1993-94 associated with the restructuring of the child benefit system;
- extraordinary transfers to the Provincial Taxation Collection Agreements Account 1993-94; and
- the impact of the February 1994 budget measures.

Table 5.8
The revenue outlook

	1993-94	1994-95	1995-96	1996-97
	(billions of dollars)			
Personal income tax	51.1	56.8	60.4	64.5
Corporate income tax	9.8	13.0	15.5	16.3
Unemployment insurance premiums	18.2	18.9	19.7	18.5
Excise taxes and duties				
Goods and Services Tax	15.7	16.6	17.4	18.3
Customs import duties	3.7	3.8	3.3	3.0
Other excise taxes	7.4	6.7	7.4	7.5
Other tax revenues	1.6	1.8	1.8	1.8
Total tax revenues	107.3	117.6	125.5	129.9
Non-tax revenues	8.7	7.4	7.7	7.5
Total budgetary revenues	116.0	125.0	133.2	137.4
	(per cent)			
Per cent of GDP				
Tax revenues	15.1	15.8	15.9	15.8
Total revenues	16.3	16.7	16.9	16.7

In contrast to the weak growth in personal incomes, corporate profits rose 43 per cent in 1994. As a result, corporate income tax collections are estimated to be $3.2 billion higher in 1994-95 than in 1993-94.

Goods and Services Tax collections are estimated to increase by 5.4 per cent, in line with the growth in the underlying tax base. Other excise taxes and duties, which include energy taxes, tobacco and alcohol taxes, were lower in 1994-95 than in 1993-94. This was largely due to the reduction in tobacco excise taxes in February 1994.

Non-tax revenues include return on investments, user fees and charges and other non-tax revenues. The decline in 1994-95 primarily reflects lower Exchange Fund earnings, given changes in exchange rates in 1994-95 compared to 1993-94.

In 1995-96, budgetary revenues are forecast to increase by $8.2 billion, or 6.5 per cent. Most of this increase reflects stronger growth in nominal income in 1995, projected to be up 5.5 per cent.

In addition, the measures announced in this and last year's budgets to improve tax fairness, to tighten tax preferences, to increase user charges and to adjust certain excise tax rates, also contribute to the growth in revenues.

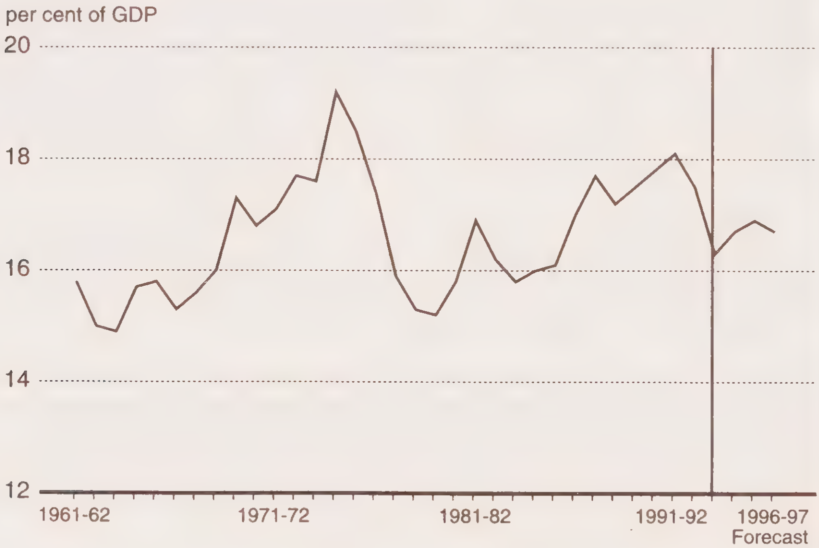
All major components, with the exception of customs import duties, contribute to the increase in budgetary revenues. Customs import duties decline as phased tariff reductions are implemented as part of the Uruguay Round of trade agreements, in addition to the ongoing reductions under the North American Free Trade Agreement.

As noted in Chapter 2, economic growth in 1996 is expected to slow as higher interest rates place a drag on household spending and slower growth in the United States restrains export expansion. As a consequence, revenue growth also slows in 1996-97, advancing by only 3.1 per cent.

Chart 5.6 shows revenues as a per cent of GDP. The lagged effect of the 1990-1991 recession, coupled with the impact of the one-time factors described above, resulted in a decline in this ratio in 1993-94. A slight increase is expected as the growth in nominal income interacts with the progressivity of the tax system and as the measures in this and last year's budgets take effect.

Chart 5.6

Budgetary revenues



The Expenditure Outlook

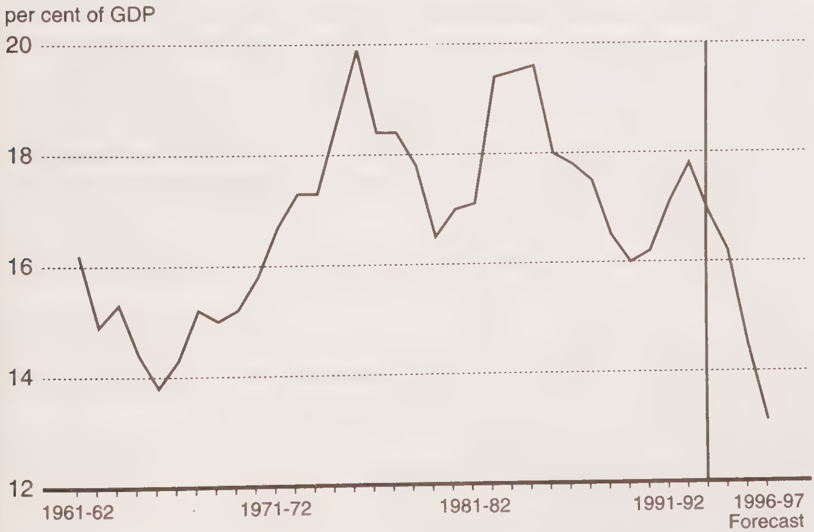
Total budgetary expenditures are expected to peak in 1995-96 at $163.5 billion, an increase of $600 million from 1994-95. Public debt charges are projected to increase by $7.5 billion, while program spending declines by $6.9 billion. Of the decline in program spending, $2.6 billion relates to the restructuring charges booked in 1994-95. Most of the remainder is due to the spending reductions proposed in this budget.

Total budgetary expenditures are projected to fall to $158.6 billion in 1996-97. All of the decline is attributable to lower program spending, reflecting the ongoing impact of the restraint measures proposed in this budget. The rate of growth in public debt charges slows in 1996-97, as the assumed decline in interest rates begins to dampen the twin effects of compounding interest and new borrowing requirements.

Budgetary expenditures are projected to fall in 1996-97

Program spending is estimated at $120.9 billion in 1994-95, up $0.9 billion from 1993-94. The spending estimate for 1994-95 includes restructuring charges of $2.6 billion associated with personnel downsizing and the buyout of the *Western Grain Transportation Act* subsidy. Excluding these restructuring costs, program spending in 1994-95 would be lower than in 1993-94.

Chart 5.7
Program spending



Lower unemployment insurance benefit payments in 1994-95, restraint measures announced in last year's budget, along with a number of extraordinary adjustments affecting spending in 1993-94 explain most of this decline in program spending. Unemployment insurance benefits are down $2.3 billion, as the improvement in the labour market, as well as reform measures announced in the last budget, resulted in fewer beneficiaries and restrained the growth of average benefits. The February 1994 budget also restrained the growth of departmental operating costs as well as defence spending. Extraordinary adjustments affecting 1993-94 included a provision for provincial claims under the Stabilization program.

Program spending is projected to decline rapidly in both 1995-96 and 1996-97, as the restraint measures proposed in this budget become effective. All major components of program spending contribute to the annual declines.

Within major transfers to persons, unemployment insurance payments are projected to continue to decline over the next two years, reflecting continued improvement in the labour market as well as further restraint measures which will take effect in 1996.

Major cash transfers to other levels of government are expected to fall $3.7 billion between 1994-95 and 1996-97. Of this decline, $2.5 billion is attributable to the proposed changes under the Canada Social Transfer.

Most of the remaining decline in the transfer reflects the formula under which entitlements are paid. As is currently the case with transfers under Established Programs Financing, entitlements under the proposed Canada Social Transfer will be paid in the form of tax point transfers and cash. The value of the tax point transfer depends on economic developments affecting the applicable tax bases. Since the growth in the value of the tax point transfers is projected to exceed the growth of overall entitlements, cash transfers are expected to decline.

Table 5.9
The expenditure outlook

	1993-94	1994-95	1995-96	1996-97
	(billions of dollars)			
A. Major transfers to persons				
Elderly benefits	19.9	20.6	21.2	21.7
Unemployment insurance benefits[1]	17.6	15.3	14.3	13.7
Veterans allowances and pensions	1.7	1.9	1.8	1.7
Total	39.3	37.7	37.2	37.2
B. Major transfers to other levels of government				
EPF/CAP/Canada social transfer[2]				
Total entitlements	(29.0)	(29.4)	(29.7)	(26.9)
Cash transfer	16.8	17.3	16.4	12.9
Equalization	7.8	8.5	8.9	9.3
Transfers to territories	1.1	1.1	1.0	1.0
Other	1.5	0.1	–	–
Total[3]	27.1	26.9	26.3	23.2
C. Subsidies and other transfers				
Business	3.7	3.8	2.5	1.9
Indians and Inuit	3.3	3.7	4.0	4.2
International assistance	2.7	2.6	2.2	2.2
Science and technology	0.9	0.9	0.9	0.9
PUITTA	0.2	0.3	0.1	–
Canada Infrastructure Works Program		0.4	0.8	0.3
Other	6.2	5.6	4.9	4.3
Total	17.0	17.3	15.4	13.8
D. Crown corporation expenditures	5.3	4.8	4.5	4.2
E. Defence[4]	10.9	10.8	10.3	9.7
F. All other departmental spending[4]	19.8	20.6	19.2	17.9
G. Other net operating requirements			0.9	1.9
H. Program spending	119.3	118.3	114.0	107.9
I. Restructuring costs	0.7	2.6		
K. Total program spending	120.0	120.9	114.0	107.9
L. Public debt charges	38.0	42.0	49.5	50.7
M. Budgetary expenditures	158.0	162.9	163.5	158.6

[1] Includes benefit payments only; administrative costs are included in all other departmental spending.
[2] Through to 1995-96 includes Established Programs Financing (EPF) and Canada Assistance Plan (CAP). For 1996-97, refers to proposed Canada Social Transfer.
[3] Includes cash transfer component.
[4] Excludes restructuring costs in 1993-94 and 1994-95 which are shown separately.

Entitlements under the Equalization program are unaffected by measures in this Budget and are projected to grow roughly in line with the growth in nominal GDP.

The restraint measures proposed in this budget dramatically reduce the funds allocated to subsidies and other transfers.

- Business subsidies are cut in half over two years, reflecting substantial reductions to transportation and agricultural subsidies and to funding for the regional agencies. As described in Chapter 4, they will continue to decline in 1997-98.
- The rate of growth in transfers to Indian and Inuit people is restrained.
- Funding for international assistance is cut by nearly $400 million in 1995-96 from the 1994-95 level.
- Grants in respect of science and technology – direct grants made by the National Research Council and the university research Granting Councils – will decline only slightly over the forecast period. Cuts are also being made to the operating budgets, which are included as part of "all other departmental spending".
- Labour market programs and cultural subsidies are also being reduced.
- The Public Utilities Income Tax Transfer is being eliminated.

Restraint measures dramatically reduce funds allocated to subsidies and other transfers

Restraint measures in this budget also account for the decline in Crown corporation expenditures to 1996-97. Defence spending was reduced in last year's budget. Further reductions are now being proposed. By 1996-97, defence spending is expected to be $1.1 billion lower than in 1994-95.

The other net operating requirements component includes centrally-held funds to assist departments in managing unavoidable cost pressures – arising within the fiscal year. These funds are significantly less than in previous budgets. Under the new Expenditure Management System, departments will have to fund new initiatives from re-allocations within existing budgets (see Chapter 4 for more details).

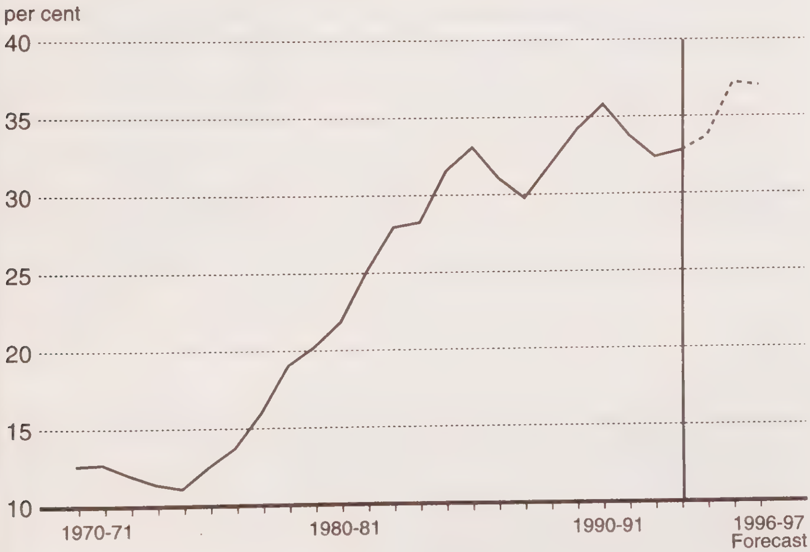
All other departmental spending consists primarily of personnel and related costs. As a result of Program Review, spending in this area will come down, primarily through the reduction in the number of public servants and the associated operating costs.

Public debt charges are expected to increase from $38 billion in 1993-94 to $50.7 billion in 1996-97 – an increase of $12.7 billion or about 33 per cent in just three years. The "interest bite" rises from just under 33 cents of each dollar the federal government collects in revenues to 37 cents in 1996-97.

In 1994-95, public debt charges are estimated to be $42.0 billion, an increase of $4.0 billion from 1993-94. Of this increase, about $2.5 billion is due to the increase in the gross stock of debt in 1994-95 with the remainder due to higher interest rates. Public debt charges are expected to reach $49.5 billion in 1995-96, $7.5 billion higher than in 1994-95. Just over $3 billion is due to the increase in the stock of debt with increases in interest rates accounting for the remainder. Interest rates are projected to fall somewhat in 1996-97. However, the impact of the lower interest rates on public debt charges in 1996-97 is more than offset by the increase in borrowing requirements in that year. As a result, public debt charges are projected to reach $50.7 billion in 1996-97.

Chart 5.8

Interest on the debt as a per cent of budgetary revenues



Financial Requirements

Financial requirements include both budgetary and non-budgetary transactions[1]. Financial requirements provide a measure of the net new borrowing requirements of the federal government in credit markets. It is also a better measurement of the fiscal situation when comparisons are made to other countries. For example, in comparing Canada's deficit to that of the United States, the unified budget of the U.S. government should be compared to financial requirements for the Canadian federal government (Annex 4 Canada–United States Fiscal Comparison).

The principle underlying the distinction between budgetary and non-budgetary transactions is that transactions changing the net indebtedness of the government are classified as budgetary while those involving offsetting financial assets and liabilities (thus leaving net debt unchanged) are classified as non-budgetary. In addition, the government maintains a number of trust accounts held for third parties – for instance, the pension accounts of its employees.

Table 5.10
Deficit, non-budgetary transactions, and financial requirements

	1993-94	1994-95	1995-96	1996-97
		(billions of dollars)		
Deficit	42.0	37.9	32.7	24.3
Non-budgetary transactions				
Loans, investments and advances	0.4	1.0	0.6	1.1
Specified purpose accounts	6.2	7.1	7.7	8.7
Other transactions	5.5	3.8	-0.5	0.8
Non-budgetary transactions	12.1	11.9	7.8	10.6
Financial requirements	29.8	26.0	24.9	13.7
Per cent of GDP	4.2	3.5	3.2	1.7

[1] Non-budgetary transactions include loans, investments and advances, primarily to Crown corporations and foreign governments, funds in the government employees' pension accounts, cash-in-transit, and accounts payable. Non-budgetary transactions also include accounting adjustments to certain budgetary transactions that are reported on an accrual basis (non-tax revenues and budgetary expenditures, including interest payments but excluding the acquisition of capital assets) to reflect the impact of these transactions on a cash basis.

Non-budgetary transactions are estimated to be $11.9 billion in 1994-95, down slightly from 1993-94. Included in the 1994-95 estimate is $2.6 billion for the restructuring charges. Although the restructuring charges adversely affect the deficit in 1994-95, they do not affect financial requirements, as little of the money will actually be paid out in 1994-95. The net source of funds declines in 1995-96, reflecting requirements for the restructuring costs associated with the actions taken in this budget. With the ending of these costs, the net source of funds rebounds to $10.6 billion in 1996-97.

Financial requirements are expected to decline from $26.0 billion in 1994-95 to $13.7 billion in 1996-97. All of this improvement is due to the decline in the deficit over that period, as the net source of funds in 1996-97 is lower than in 1994-95. As a percentage of GDP, financial requirements fall to 1.7 per cent in 1996-97, the lowest ratio since 1973-74.

Financial requirements are expected to decline

Borrowing Authority

The amount of borrowing authority requested from Parliament for a fiscal year has traditionally been tied to the financial requirements forecast for that year, adjusted for estimated Exchange Fund earnings. Borrowing authority to cover Exchange Fund earnings is sought because these earnings, although reported as budgetary revenues, remain in the Exchange Fund Account and are not available to finance the ongoing operations of government. In addition, a non-lapsing amount of $3 billion is requested, which can either be used during the course of the year to manage contingencies, such as unexpected foreign exchange requirements, or can be carried forward into the next fiscal year. Any borrowing authority remaining above that amount at the end of the fiscal year lapses.

The government will be introducing legislation seeking borrowing authority of $28.9 billion, consisting of financial requirements of $24.9 billion, expected Exchange Fund earnings of $1 billion and $3 billion of non-lapsing authority.

Table 5.11
Borrowing requirements

	1995-96
	(billions of dollars)
Deficit	32.7
Non-budgetary transactions	7.8
Financial requirements (excluding foreign exchange requirements)	-24.9
Exchange fund earnings	-1.0
Non-lapsing authority	-3.0
Total borrowing authority requested	-28.9

6

Profile of federal departmental spending

This chapter provides additional information on federal departmental spending and decisions resulting from Program Review. It excludes the major transfers to persons and other levels of government. Departmental spending, excluding these transfers, was slightly under $52 billion in 1994-95.

The following describes the key actions that will be taken by departments to adjust to new mandates and to fulfil those mandates more cost-effectively. These actions exemplify the structural changes needed for a continuous process of improvement in government efficiency. The new Expenditure Management System and the detailed scrutiny of all departmental spending under Program Review will fundamentally change the operations of the federal government. *Getting government right* does not end with this budget.

Getting government right does not end with this budget

Sustainable Development in the Natural Resource Sector

A number of departments including Agriculture and Agri-Food Canada, Environment Canada, Fisheries and Oceans and Natural Resources Canada play an important role in promoting sustainable development in the natural resource sector. The overall objective of federal activities in these areas is to support the sustainable development of Canada's natural resources so as to maximize economic benefits while ensuring that the quality of the environment is protected and enhanced.

Agriculture and Agri-Food Canada

Agriculture and Agri-Food Canada promotes the growth and security of the agri-food sector and helps ensure a dependable supply of safe, nutritious food. It does this by conducting research, helping to stabilize farm incomes, overseeing the supply management of certain commodities, providing inspection and quarantine services, facilitating environmental sustainability, adaptation and promoting trade and market development.

As a result of Program Review, the department will refocus its efforts on fostering greater growth and security for the industry while reducing dependence on government support. More specifically, the department will:

- in co-operation with the Department of Transport, terminate the current transportation subsidy under the *Western Grain Transportation Act* (WGTA). A package of transitional measures will be provided, including a capital payout of $1.6 billion to owners of Prairie farm land, and a multi-year WGTA adjustment package of $300 million;

A "whole farm" approach will encourage innovation and diversification

- refocus agriculture safety net programs away from a commodity specific design towards a "whole farm" approach to shift the emphasis from income support to income stabilization. This will promote greater responsiveness to industry while encouraging greater innovation and diversification. Federal contributions for safety nets will be reduced by 30 per cent over the next three years;
- create an Agri-Food Trade Service to integrate and co-ordinate existing and new initiatives in support of trade and market development through a single-window approach;
- devote more resources to capital availability, human resource development, infrastructure and other initiatives that focus on agriculture sector diversification and adaptation;
- reduce the subsidy paid to industrial milk producers by 30 per cent over two years, and review the future of the remaining subsidy funds in consultation with the industry and the provinces;
- reduce and redirect federal resources devoted to inspection and regulation activities through, for example, reducing overlap and duplication, increasing recovery of costs as well as sharing of responsibilities and streamlining arrangements with industry;

- allocate resources to fund a Matching Investment Initiative to provide up to $70 million ($35 million from Government and $35 million from industry) in joint research projects led by industry; close seven research facilities and reduce research activities in areas of lower priority – for example, where the value of the crop is relatively small; where technology is potentially available from other sources; or where the impact is of a more local/regional nature;
- terminate the Feed Freight Assistance transportation subsidy and provide transitional funding over the next 10 years. The Minister of Agriculture and Agri-Food will consult with industry and the provinces on how the transitional funds will be used to enhance the competitiveness of industry in affected regions.

The department's spending will decline by $445 million over the next three years.

Agriculture and Agri-Food Canada

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings[1]		215	128	272
Authorized spending level[2]	2,073	1,938	1,890	1,628

[1] Savings include additional cost-recovery revenues and/or revenue enhancements.

[2] These numbers incorporate expenditure reductions only. They do not include cost-recovery or other revenues that appear in non-tax revenues.

Fisheries and Oceans

The Department of Fisheries and Oceans is responsible for conserving and protecting the fishery resource base and managing the commercial, Aboriginal and recreational fisheries in marine and some inland waters. The Department is also responsible for co-ordinating Canada's policies and programs respecting ocean resources.

As a result of Program Review, the department will refocus its role on conservation and the sustainable use of fisheries and oceans resources. It will:

The department will refocus on conservation and sustainable use of resources

- negotiate with provinces to transfer authorities for freshwater habitat management and other related inland water responsibilities;
- strengthen Canada's capabilities and effectiveness in oceans policy making;

- integrate the operations and fleet of the Canadian Coast Guard with the Department of Fisheries and Oceans in order to increase efficiency;
- redirect scientific services to support the department's core mandate, thus making them more responsive to client needs;
- divest recreational harbours to municipalities or other interested parties and rationalize commercial fishing harbours, including implementing higher fees for use;
- seek to enter into partnerships with the fishing industry and others in the management of capacity, licensing and compliance;
- look to industry to pay more for access privileges, contribute towards the cost of managing the fishery and pay higher fees for services; and
- withdraw from the provision of developmental assistance and industry support, including the phasing out of the Fishing Vessel Insurance Program and the wind-up of the Fisheries Prices Support Board.

Spending by the department will decline by $211 million over the next three years.

Fisheries and Oceans

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings[1]		51	80	110
Authorized spending level[2]	775	897	652	565

[1] Savings include additional cost-recovery revenues and/or revenue enhancements.

[2] These numbers incorporate expenditure reductions only. They do not include cost-recovery or other revenues that appear in non-tax revenues.

Natural Resources Canada

Natural Resources Canada promotes the sustainable development and responsible use of Canada's resources and the international competitiveness of Canada's energy, forest, mining and geomatics industries.

The department will maintain a presence in areas of federal responsibility, such as in international trade and science and technology. The federal role will be exercised through leadership, co-ordination and partnerships with the provinces and stakeholders.

Approximately three-quarters of the department's resources will be devoted to scientific and technical activities, with the remainder divided among policy development, energy efficiency, and alternative energy programs and administration. Much of the department's scientific work will be delivered through a consolidated network of regional laboratories.

The department will take a more strategic approach to its policy and science activities. It will:

- reorient energy policy from a traditional focus on supply to an increased emphasis on efficiency and alternative energy sources, the environment and sustainable development;
- focus mining and forest policy on international issues, and sustainable development;
- discontinue the Forest Resource Development Agreements and Mineral Development Agreements, ending over 25 years of these types of agreements;
- end direct financial support after 1995-96 for energy mega projects, once the Hibernia project is completed;
- consolidate 16 forestry centres and offices into five centres with national mandates;
- undertake geological research on a cost-shared and jointly-sponsored basis in collaboration with the provinces and the private sector; and
- reorganize geomatics activities (computer-based surveying, mapping and remote sensing) and move towards Special Operating Agency status.

Direct financial support for energy mega projects will end

Spending in the Natural Resources Canada portfolio will fall by $624 million over the next three years, and over 20 regional offices and labs will close.

Natural Resources Canada

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings		26	82	68
Authorized spending level	1,262	1,087	753	638

Environment Canada

Environment Canada's mandate is to preserve and enhance the quality of the natural environment and promote sustainable development. It also promotes and encourages the adoption of environmentally sound practices through strategic partnerships.

Additional emphasis will be placed on science and policy

In future, the department will maintain its role in environmental protection and in promoting sustainable development. It will place relatively more emphasis on its science and policy responsibilities. The department will:

- shift emphasis to where it can make the largest strategic contributions – for example, in international and national policy and nationally significant ecosystems and deliver local weather and other services through modern information technologies;
- maintain research critical to federal responsibilities. This will entail rationalization and reduction of support for research in some areas; and
- consolidate and automate atmospheric environment activities and explore alternatives for more efficient delivery of weather services, including commercialization. This will result in the closure of over 50 weather offices and laboratories.

The Minister of Environment will also develop, in consultation with concerned ministers, provinces and stakeholders, proposals for recovering all costs attributable to environmental assessments as well as options for streamlining procedures and timelines for the environmental assessment process.

While funding for some programs is scheduled to terminate at the end of 1996-97, Environment Canada has assessed its priorities for all environmental spending, and will accommodate these priorities in the spending reference levels shown below through 1997-98.

The department's spending will decline $234 million over the next three years.

Environment Canada

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings		35	90	131
	737	630	553	503

Transport Canada

The federal government promotes the development and maintenance of a safe and efficient national transportation system through the programs of Transport Canada, the National Transportation Agency, and a number of Crown corporations and other agencies, all of which report to the Minister of Transport.

As a result of Program Review, the Department will shift its role from being an operator of the transportation system to focus on core roles of developing policy and legislation and enforcing standards for safety and security.

Focus will shift to policy and legislation, as well as enforcement for safety and security

More specifically, it will:

- revise its policies and regulations to ensure a viable efficient and safe air, rail and marine transportation system;
- commercialize many of its current operations, including the transfer of airports to local authorities and the commercialization of the Air Navigation System;
- reduce or eliminate transportation subsidies, including subsidy programs for grain farmers under the *Western Grain Transportation Act* (WGTA) and for transportation companies under the *Atlantic Region Freight Assistance Act* (ARFAA) and *Maritime Freight Rates Act* (MFRA);
- achieve greater efficiencies in activities of the Coast Guard through changes in its operating role and levels of service and through integration of its operations and fleet with the Department of Fisheries and Oceans; and
- introduce new cost-recovery measures and increase existing fees to generate a better balance between operating costs and revenues. This will include, for example, full cost recovery of the provision of *en route* air navigation services to aircraft that traverse Canadian airspace (without landing).

Transport Canada will act as landlord in cases where commercialized assets remain federal property, and continue to ensure reasonable service to Canada's remote communities and for Canadians with disabilities.

Departmental spending will decline by $1,447 million over the next three years, reflecting the substantial reduction in subsidies and operating responsibilities.

Transport Canada

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings[1]		555	953	1,111
Authorized spending level[2]	2,851	2,098	1,647	1,404

[1] Savings include additional cost-recovery revenues and/or revenue enhancements.

[2] These numbers incorporate expenditure reductions only. They do not include cost-recovery or other revenues that appear in non-tax revenues.

Industrial, Regional, and Scientific-Technological Departments and Agencies

The general objectives of federal spending in Industrial, Regional and Science and Technology areas are to enhance economic growth through measures that foster private sector investment, encourage regional development and build a stronger science and technology capability in Canada.

Industry Canada

Industry Canada's mandate is to foster the competitiveness and excellence of Canadian industry, to co-ordinate federal science and technology policy, and to ensure a fair efficient marketplace for all participants.

As a result of Program Review, and consistent with the government's broad-based move away from subsidies and direct business support, Industry Canada will:

- further reduce subsidies to business;
- shift remaining spending towards initiatives in high-growth sectors, to be delivered in partnership with the private sector;
- radically reduce and refocus the industry sector branches in support of industrial competitiveness; and

- eliminate regional industrial programming and service delivery where there is clear overlap with other federal agencies.

Federal agency overlaps will be eliminated

Industry Canada's spending will fall by $560 million over the next three years.

Industry Canada and Specified Agencies[1]

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings[2]		93	148	212
Authorized spending level[3]	1,301	1,291	793	742

[1] Includes Industry Canada, Competition Tribunal, Copyright Board, Federal Business Development Bank, Standards Council, and the Cape Breton Development Corporation.

[2] Savings include additional cost-recovery revenues and/or revenue enhancements.

[3] These numbers incorporate expenditure reductions only. They do not include cost-recovery or other revenues that appear in non-tax revenues.

Canadian Space Agency

The mandate of the Canadian Space Agency is to promote the peaceful use and development of outer space, to advance knowledge of space through science, and to ensure that space science and technology provide social and economic benefits for Canadians.

As a result of Program Review, the Canadian Space Agency will focus increasingly on private sector partnerships and joint ventures for earth observation, space science and technology.

This action, combined with the completion of Radarsat and the main manufacturing phase of the Space Station, and reductions in Canada's participation in this international project, will result in a spending decline of $168 million over the next three years.

Canadian Space Agency

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings		20	32	40
Authorized spending level	316	302	212	148

The Granting Councils: NSERC and SSHRC

The Natural Sciences and Engineering Research Council of Canada (NSERC), and the Social Sciences and Humanities Research Council of Canada (SSHRC) promote and assist primarily university research and graduate education.

In view of the government's priority to support the training of highly qualified people and the advancement of knowledge, the budgets of the Granting Councils are being reduced by less than those of most other economic activities. Expenditures will fall by $77 million over the next three years.

The Granting Councils

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings		30	65	84
Authorized spending level	595	563	531	518

National Research Council (NRC)

The NRC contributes to the economic and social well being of Canada through support of a broad range of national science and engineering activities, including research and development, and the provision of technical advice to business and government.

As a result of Program Review, the NRC will be required to eliminate activities of lower priority. Expenditures will fall by $76 million over the next three years.

National Research Council

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings		21	11	17
Authorized spending level	449	409	384	373

Regional Development Agencies

There are four regional development agencies that promote economic development in specific regions: the Department of Western Economic Diversification Canada (WD); the Federal Office of Regional Development -- Quebec (FORD-Q); the Atlantic Canada Opportunities Agency (ACOA) and Federal Economic Development in Northern Ontario (FEDNOR) – a regional office of Industry Canada. The agencies also advocate the interests of their region in the development and implementation of national policies and programs.

As a result of the Program Review, the regional development agencies will:

Regional development agencies will harmonize activities and focus on SMEs

- focus their assistance on small and medium-sized enterprises (SMEs);
- make even more extensive use of repayable contributions and loans instead of grants;
- continue to work strategically with the provinces to harmonize activities and to reduce overlap and duplication in assistance to business; and
- work to address the concerns and needs of small- and medium-sized enterprises with regard to access to capital, and concentrate increasingly on providing and brokering information services and other indirect support to promote innovation, improved market access and entrepreneurship;
- assume responsibility, from Human Resources Development, for the Community Futures Program at reduced funding levels.

Funding for the regional agencies will decline by $562 million over the next three years.

Regional Development Agencies

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings[1]		144	220	227
Authorized spending level[2]	1,138	1,313	798	576

[1] Savings include additional cost-recovery revenues and/or revenue enhancements.

[2] Includes infrastructure spending. These numbers incorporate spending reductions only. They do not include cost-recovery or other revenues that appear in non-tax revenues.

Justice and Legal Programs

Justice Canada

The Department of Justice Canada provides legal services to the Government of Canada and develops policies for the administration of justice.

In addition to the Department, the portfolio includes: the Supreme Court of Canada; the Federal and Tax Courts of Canada; the Canadian Human Rights Commission; and the Offices of the Commissioners for Federal Judicial Affairs, Information, and Privacy.

As a result of Program Review, the department will:

Simplifying the justice system will generate savings

- develop new initiatives to help simplify the justice system and generate savings to the system where possible, including sentencing reform, reviewing governmental regulation and legislation, and placing greater reliance on measures such as mediation as an alternative to litigation;
- achieve further efficiencies in federal-provincial cost-sharing under the Criminal Legal Aid and Young Offender Program agreements;
- improve cost effectiveness of government legal services by creating new opportunities with government client departments to help change policies and practices to reduce legal problems, negotiate service agreements with all government clients which establish clear priorities and level of services to be provided and, establish cost recovery pilot projects with client departments;
- conduct studies, in collaboration with the Federal and Tax Courts, on the possible merger of the Federal Court-Trial Division and the Tax Court, and the possible relocation of judges outside the National Capital Region, with a view to achieving cost savings.

The Department of Justice's spending will fall by $64 million over the next three years.

Justice Canada

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings[1]		6	12	17
Authorized spending level	757	737	717	693

[1] Does not include immigration adjustments.

Solicitor General Canada

The Solicitor General Canada has broad responsibility for federal corrections, policing and security. Eight organizations report to Parliament through Solicitor General Canada, including the Secretariat, the RCMP, the Correctional Service of Canada, the National Parole Board and the Canadian Security Intelligence Service (CSIS).

As a result of Program Review:

- the Solicitor General Secretariat, while retaining responsibility for First Nations Policing, will be a smaller, more focused policy centre with the primary role of providing support to the Solicitor General with strategic policy advice in the areas of corrections, parole, policing and national security;
- five regional offices will be closed, funds to university centres of criminology will end, and other grants and contributions will be streamlined;
- Solicitor General Canada will develop, in consultation with Justice Canada and provincial governments, a strategy for containing the rate of growth of the inmate population and the associated correctional costs;
- the National Parole Board, pursuant to legislative and regulatory amendments, will modify the statutory requirement to review candidates for conditional release from a yearly review to a biennial review it will also reduce the quorum for certain decisions;
- the RCMP will work with Transport Canada to identify opportunities for increasing the efficiency of airport security;
- the RCMP will explore with other relevant departments opportunities for consolidating federal criminal law enforcement activities in the RCMP;
- the RCMP Public Complaints Commission will be reduced through the elimination of 15 Governor-in-Council positions; and
- CSIS will reduce costs.

Correctional costs and the growth in the inmate population will be examined

Spending as the Solicitor General's portfolio will decline by $102 million over the next three years.

Solicitor General Canada[1]

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings[2]		25	47	58
Authorized spending level[3]	2,541	2,564	2,536	2,439

[1] Excludes expenditures which are part of the International Assistance Envelope.

[2] Savings include additional cost-recovery revenues and/or revenue enhancements. They do not include immigration adjustments.

[3] These numbers exclude International Assistance Envelope funding. These numbers incorporate expenditure reductions only. They do not include cost-recovery or other revenues that appear in non-tax revenues.

Canadian Heritage

Canadian Heritage promotes the development of Canada's culture, linguistic duality, and diverse multicultural heritage and is responsible for National Parks and historic sites, amateur sport as well as Canada's broadcasting policy. The Department is also responsible for developing the broad policy framework within which cultural Crown corporations, including the CBC, operate.

As a result of Program Review:

- the department will maintain its role in each of these areas, but its ongoing activities will be streamlined to encourage greater self-sufficiency;
- the CBC, Telefilm Canada and the National Film Board of Canada (NFB) will be subject to cuts in the coming fiscal year of 4, 5 and 5 per cent respectively;
- the government will undertake a fundamental review of its support to, and the mandates of, the CBC, NFB and Telefilm Canada. Strategies and mandates that were developed under radically different circumstances must be re-examined in light of today's technological possibilities and the evolution of both the audio-visual industry and the domestic market. The review of the CBC mandate will draw from the work undertaken by the Standing Committee on Canadian Heritage on the role of the CBC in the multi-channel universe;

Strategies and mandates must be re-examined

- the operations of various other cultural agencies, commissions and corporations will be reviewed to reflect tighter fiscal circumstances;

- Parks Canada will implement reductions by managing its program differently and to this end, is developing a new national business plan. Operating costs at national parks and national historic sites will be reduced while maintaining responsible levels of service;
- the National Capital Commission will reduce its work force, strive for greater municipal participation in maintaining municipal-like assets, operate on a more commercial basis and continue to divest land holdings that are not critical to its role as a National Capital organization; and
- The Women's Program of Human Resources Development will be consolidated with Status of Women Canada. This "single window" approach will result in a streamlining of resources and costs, the elimination of duplication, and an improvement of service to the public.

The department's spending level, including support for Crown corporations, will decline by $676 million over the next three years.

Canadian Heritage

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings[1]		142	274	387
Authorized spending level[2]	2,897	2,677	2,421	2,221

[1] Savings include additional cost-recovery revenues and/or revenue enhancements.

[2] These numbers incorporate expenditure reductions only. They do not include cost-recovery or other revenues that appear in non-tax revenues.

Foreign Affairs and International Trade

The department promotes increased trade and commercial relations and represents Canadian interests in world affairs. With the support of services provided by the Export Development Corporation (EDC), the department fosters growth and job creation through pursuit of commercial opportunities abroad.

As a result of Program Review, the department will:

- consolidate delivery of its services through the sale of property and downsizing of major missions;
- shift a greater portion of the cost of consular and trade development functions to the prime users; and
- transfer Radio Canada International to the CBC.

Departmental funding will decline by $257 million by 1997-98.

Foreign Affairs and International Trade[1]

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings[2]		109	134	171
Authorized spending level[3]	1,488	1,343	1,289	1,231

[1] Excludes expenditures which are part of the International Assistance Envelope, including the International Development Research Centre.

[2] Savings include additional cost-recovery revenues and/or revenue enhancements.

[3] These numbers incorporate expenditure reductions only. They do not include cost-recovery or other revenues that appear in non-tax revenues.

The International Assistance Envelope (IAE)

Assistance to developing nations was set at $2.6 billion in the February 1994 budget. The largest part of this funding is managed by the Canadian International Development Agency (CIDA). The major purpose of the program is to support sustainable development in developing countries, in order to reduce poverty and contribute to a more secure, equitable, and prosperous world.

As well, the Department of Finance provides support to international financial institutions such as the World Bank. Also included in the IAE are expenditures in other departments such as Foreign Affairs and International Trade related to international development.

As a result of Program Review, CIDA will:

- reduce administrative costs and overhead, for example by streamlining business processes;
- reduce program activities; and
- reduce, over time, contributions to international financial institutions to a level that balances Canada's international interests with fiscal capability.

IAE's annual expenditures will be reduced by $532 million by 1997-98.

International Assistance Envelope[1]

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings		381	381	540
Authorized spending level	2,594	2,220	2,220	2,061

[1] Includes CIDA and IAE spending in Finance, Foreign Affairs and Solicitor General.

Social Programs (Excluding Major Transfers)

Citizenship and Immigration Canada

Citizenship and Immigration Canada develops immigration policy, manages immigration levels, facilitates and controls admission to Canada of visitors, permanent residents and refugees, and grants Canadian citizenship to eligible newcomers.

As a result of Program Review, the department is changing the direction of Canada's immigration and citizenship policies. The Minister's *Strategic Framework* sets out an agenda to ensure that the program more fully supports Canada's economic, social and international policy objectives and continues to support Canada's humanitarian mission. This includes streamlining the program, improving the quality of service, developing new partnership approaches for the management of settlement services, and securing Canada's refugee program to ensure that efficiency savings in the refugee determination system are used to protect those in greatest need of protection.

To make the immigration program fairer and more affordable as well as to reduce the burden on provincial social services, the government will:

- starting February 28, 1995, charge each adult applying to immigrate to Canada an immigration fee of $975. The fee will be collected on application, and refunded to those whose applications are not accepted. To ensure equitable access, loans will be made available to immigrants and refugees who require assistance in paying the fee;

- increase citizenship fees including the introduction of a fee for right of citizenship, to cover costs of all citizenship activities; and
- develop some form of a financial guarantee to ensure that sponsors meet their sponsorship obligations. This will further reduce the cost of immigration to Canadian taxpayers and provinces. Details will be announced by the Minister of Citizenship and Immigration in the near future.

Departmental spending levels reflect significant financial pressures faced by Citizenship and Immigration Canada for settlement services and growing obligations for enforcement and public safety. Some of these pressures will be offset by the new fees. The department's spending will fall by $62 million over the next three years.

Citizenship and Immigration Canada[1]

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings[2]		100	69	103
Authorized spending level[3]	663	670	665	601

[1] Includes Immigration and Refugee Board.

[2] Savings include additional cost-recovery revenues and/or revenue enhancements and immigration adjustments.

[3] These numbers incorporate expenditure reductions only. They do not include cost-recovery or other revenues that appear in non-tax revenues.

Health Canada

Health Canada acts to protect and improve the health of Canadians. This national mandate encompasses administration of the *Canada Health Act*, health policy development, national health surveillance, disease control and prevention, health promotion and regulations to manage health risks.

Health Canada also provides Status Indians and Inuit with programs and services in areas such as community health, hospital and treatment services and non-insured health benefits.

Three agencies complement the health mandate: the Medical Research Council, the Patented Medicines Prices Review Board and the Hazardous Materials Information Review Commission.

As a result of Program Review:

- many programs will be reduced with some of the savings reinvested to address priorities such as enhancements to the public health intelligence network, breast cancer research, Prenatal Nutrition, and Aboriginal Headstart;
- the Departments of Health, Agriculture, Fisheries and Oceans and Industry will co-operate, in consultation with the food industry and the provinces, to improve the effectiveness and cost efficiency of the federal component of the Canadian food inspection system, including possible changes in organizational structure;
- additional cost-recovery measures will be implemented and administrative costs reduced;
- funding for the Medical Research Council will be reduced by 10 per cent over the next three years, while funding for the Patented Medicine Prices Review Board and the Hazardous Materials Information Review Commission will be reduced by 15 per cent; and
- the rate of growth of the Indian Health Services Program of Health Canada will be restricted to 6 per cent in 1995-96 and 3 per cent per year for the following two years. The Minister of Health will invite First Nations and Inuit leaders to participate in developing a national framework which will allow the program to be managed within these growth limits.

Health Canada's expenditure level, excluding Established Programs Financing–Health transfers to the provinces, will be reduced by $70 million over the next three years as a result of these decisions.

Health Canada[1]

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings[2]		49	138	201
Authorized spending level[3]	1,815	1,907	1,879	1,746

[1] Includes Indian Health.

[2] Savings include additional cost-recovery revenues and/or revenue enhancements.

[3] These numbers incorporate expenditure reductions only. They do not include cost-recovery or other revenues that appear in non-tax revenues.

Human Resources Development Canada

Human Resources Development Canada administers unemployment insurance, income security programs for children and the elderly, the current federal programs of support to provinces for post-secondary education and welfare, labour market adjustment and social development programs, and student loans.

Consideration to be given to more flexible use of unemployment insurance funds

As part of Program Review and the government's overall reform of social security programs, the department will be streamlining and restructuring its programs and services, within a smaller global budget. Current programs financed through the Consolidated Revenue Fund will be combined into a unified Human Resources Investment Fund which will focus on actively helping unemployed people find and keep jobs, combating child poverty, and providing assistance to those who need help most. In addition, as stated in last October's discussion paper, *Improving Social Security in Canada*, consideration will be given to more flexible use of unemployment insurance funds in order to provide more effective employment assistance to Canadians.

The consolidation of programs and services will result in savings of $600 million in 1995-96 and $1.1 billion in 1996-97 and each year thereafter. This will be achieved primarily by reducing the current Canadian Jobs Strategy, spending less than originally planned under the Strategic Initiatives program, and freezing maximum transfers to provinces under the Vocational Rehabilitation for Disabled Persons program at the 1994-95 level, as well as streamlining departmental operations including the consolidation of some offices and the closure of others.

The restructuring of programs and services, along with the reallocation of a significant portion of the savings generated by Unemployment Insurance reform, will ensure the most effective and efficient use of available resources to support better employment opportunities and prospects for Canadians. Examples of some of the initiatives which would be undertaken include:

- more emphasis on employment development services, such as initial needs assessment, counselling, literacy and basic skills training, workplace training and experience, child care support, and earnings supplementation;
- improved national labour market information, including the use of new technology, to enable Canadians to more easily match their skills and qualifications with the availability of jobs across the country;

- a national workplace strategy, including working more closely with sector councils, to facilitate adjustment to changing economic conditions and labour market needs; and

- assistance to persons with disabilities to help them achieve greater independence and participation in the workplace and in society in general.

Greater independance and workplace participation for the disabled

The Minister of Human Resources Development will be developing program parameters over the coming months and announcing the details of the new Human Resources Investment Fund in the fall as part of Social Security Reform.

Spending on the department's programs subject to Program Review will fall by $885 million over the next three years.

Human Resources Development Canada

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings[1]		600	1,100	1,100
Authorized spending level[2]	2,544	2,383	1,755	1,660

[1] Savings include additional cost-recovery revenues and/or revenue enhancements.

[2] These numbers incorporate expenditure reductions only. They do not include cost-recovery or other revenues that appear in non-tax revenues.

Indian Affairs and Northern Development

The Department of Indian Affairs and Northern Development has the primary federal mandate for the provision of basic services to Status Indians living on reserves and on Crown lands, and to Inuit; fulfilling federal obligations flowing from treaties, the *Indian Act*, and the settlement of land claims; supporting political and economic development in the North; protecting the Northern environment; administering formula financing agreements with the Yukon and the Northwest Territories; and administering federal lands and resources in the territories.

As a result of Program Review:

- there will be no major changes to the existing mandate of the department, but growth will be constrained, forcing programs to be more focused and efficient; and

- spending by Indian Affairs and Northern Development on Indian and Inuit programming (excluding recent land claims and other minor adjustments including post-secondary education) will grow by 6 per cent in 1995-96 and 3 per cent per year for the following two years – consistent with the growth of the Aboriginal population.

As a result, growth in the department's expenditures will be lower than the average of over 8 per cent per year recorded over the last decade.

Indian Affairs and Northern Development[1]

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings[2]		5	97	177
Authorized spending level[3]	3,761	4,046	4,114	4,208

[1] Indian Health under Health Canada.

[2] Savings include additional cost-recovery revenues and/or revenue enhancements.

[3] These numbers incorporate expenditure reductions only. They do not include cost-recovery or other revenues that appear in non-tax revenues.

Canada Mortgage and Housing Corporation

Bulk of federal transfers are for social housing programs

Through the Canada Mortgage and Housing Corporation (CMHC), the federal government assists Canadians to obtain affordable and adequate shelter. The bulk of federal transfers to the corporation are for the social housing programs that subsidize the cost of shelter for low-income families. CMHC also administers the mortgage insurance program and the mortgage backed securities program, and provides research information and support services to the housing industry in Canada.

Most of CMHC's spending on social housing is used to pay subsidy obligations for existing housing. Very little is associated with new housing assistance.

As a result of Program Review:

- CMHC will continue to provide subsidies for existing social housing units, renovation assistance, and housing on Indian reserves;
- funding for new social housing initiatives will be further reduced starting in 1995-96; and
- funding for housing research and administration will be reduced.

Canada Mortgage and Housing Corporation

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings		64	115	128
Authorized spending level	2,131	2,026	1,968	1,942

Veterans Affairs Canada

Veterans Affairs Canada provides benefits and services to veterans and their dependants, survivors of veterans and eligible civilians, including disability pensions, income support, health care and other benefits. All essential programs and services will be preserved for veterans who have served Canada. However, steps will be taken to control costs, eliminate overlap and duplication, and return programs to their original purpose.

All essential programs and services will be preserved

As a result of Program Review:

- War Veterans' Allowance and related benefits for former members of the resistance and for Allied veterans living abroad for more than 6 months will be discontinued;
- the Pensioners' Training and the Educational Assistance programs will be discontinued, since they overlap with other sources of funding for such services;
- health care treatment benefits will be more tightly focused on clients' needs; and
- travel allowances related to health services will be curtailed.

The spending estimates reflect demographic projections which indicate that total client numbers for the three major program areas will continue to decline in future years. They also make provision for changing health care and other needs arising as a consequence of the ageing of the veteran population to an average age of 75 by 1997.

Veterans Affairs Canada

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings		59	61	62
Authorized spending level	2,088	1,966	1,901	1,857

National Defence

Last December, the government released the *1994 Defence White Paper*. The White Paper was the result of a comprehensive review of Canada's post-Cold War defence requirements. It affirmed that multi-purpose, combat-capable sea, land, and air forces were vital national assets that were required to address Canada's security needs, both at home and abroad.

Delivery of defence will be streamlined

The White Paper and the funding levels set out in this budget were developed in concert. The new policy is, therefore, entirely consistent with the need to address the broader national task of deficit reduction. In order to maintain essential military capabilities at a time of fiscal restraint, the Department of National Defence will streamline the delivery of defence. This will entail:

- personnel reductions that will result in about 60,000 Regular Force personnel, 23,000 Primary Reservists, and 20,000 civilian employees by 1999;
- infrastructure reductions beyond those set out in the 1994 federal budget;
- devoting a higher proportion of available resources to operational needs and adjusting the balance of resources between the maritime, land, and air forces;
- the adoption, by mid-1997, of a leaner command and control structure, which consumes some one-third fewer resources and eliminates the environmental command headquarters;
- reductions in capital spending from planned levels of at least $15 billion over the next 15 years, and proceeding, in the near term, with priority acquisitions of equipment to meet the most critical needs of a multi-purpose, combat-capable force; and
- the adoption of improved management practices at all levels of the Department and the Forces, including greater emphasis on "off-the-shelf" procurement and an enhanced partnership with the private sector.

National Defence[1]

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings		350	557	1,033
Authorized spending level	11,574	11,027	10,495	9,925

[1] Includes Emergency Preparedness Canada. These estimates differ from those presented in Chapter 5 as they do not include adjustments related to the amortization of pension plan surpluses.

General Government Services

Public Works and Government Services Canada

Public Works and Government Services Canada (PWGSC) is a major provider of central and common services to the Government of Canada. It is the government's chief purchasing agent, landlord, publisher, banker, accountant and paymaster, and provides real estate, design and construction, telecommunications, informatics and translation services.

It is also responsible for the provision of office and general purpose accommodation to some 180,000 federal employees including the management and disposition of real property. The department also manages the payment of grants-in-lieu of taxes to municipalities and other taxing authorities.

As a result of Program Review, PWGSC will realize savings of about $398 million over the next three years, through:

Operating efficiencies will save about $398 million

- more efficient business lines, streamlining operations and increased delegation;
- the consolidation of cheque production and printing sites and data centres;
- the termination of Stocked Item Supply and closure of stores and warehouses;
- the commercialization of all or part of the Canada Communication Group;
- increased use of direct deposit;
- implementation of government-wide financial and compensation systems; and
- savings from reductions in requirements of office space as a result of public service downsizing and more efficient management of accommodation.

Public Works and Government Services Canada[1]

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings[1]		52	121	178
Authorized spending level	1,907	1,767	1,617	1,509

[1] Including Canada Post and the Canadian Commercial Corporation.

Revenue Canada

Revenue Canada is responsible for administering Canadian tax, border, and trade policies. It collects federal income tax; personal income tax on behalf of all provinces except Quebec; corporate income tax on behalf of all provinces except Alberta, Ontario and Quebec; the Goods and Services Tax (GST) in all provinces except Quebec; commodity taxes, excise duties and import levies; provincial sales, alcohol and tobacco taxes at the border on behalf of certain provinces; employee and employer contributions under the Canada Pension Plan; and employee and employer premiums for Unemployment Insurance.

Revenue Canada also administers a wide variety of the government's trade policy instruments and enforces Canadian laws and sovereignty at the border to protect Canadian business, individuals and society generally from inadmissible or dangerous goods and people. In addition, Revenue Canada supports the social and economic programs and goals of the government through administration of legislation, international treaties and agreements and other federal and provincial statutes and regulations.

Greater emphasis on audit and other enforcement activities

As a result of Program Review, the department will:

- implement efficiency improvements within existing programs, including consolidating a number of activities; and
- reallocate certain savings to its audit and other enforcement activities.

Departmental spending will decline $230 million over the next three years.

Revenue Canada

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings[1]		156	223	278
Authorized spending level[2]	2,207	2,127	2,073	1,977

1 Savings include additional revenue enhancements. It also includes 2-per-cent increase in interest rate on unpaid taxes. This interest income is shown as part of non-tax revenues.

2 These numbers incorporate expenditure reductions only. They do not include cost-recovery or other revenues that appear in non-tax revenues.

Privy Council Office

The Privy Council Office (PCO) provides necessary support for operation of the Cabinet system and assistance to the Prime Minister in carrying out his responsibilities as Head of Government.

PCO and related agencies will implement a variety of efficiency improvements and streamlining measures to deal with declining resource levels, reducing spending by $118 million over the next three years.

Privy Council Office

	1994-95	1995-96	1996-97	1997-98
	(millions of dollars)			
Total budgetary savings		5	10	15
Authorized spending level	231	158	120	113

Treasury Board Secretariat

The Treasury Board Secretariat is responsible for recommending and providing advice on policies, directives, regulations and program expenditure proposals in respect of the management of the government's financial, human and materiel resources.

As a result of decisions made in Program Review, the Treasury Board Secretariat will:

- undergo a fundamental change in its functions to support the widespread changes in programs and operations of the federal government;
- focus its operations on providing a framework for management of the public service; on resource allocation; and on providing leadership in innovation and management practices;
- provide leadership in quality service delivery across the public service;
- reduce the number of required reports and submissions from other departments; and
- implement the Expenditure Management System.

Focus on management framework for the public service

As a result of these actions, spending will decline $15 million over the next three years.

Treasury Board Secretariat

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings		4	8	12
Authorized spending level	87	83	78	72

Finance

The Department of Finance is responsible for providing advice on the economic and financial affairs of Canada.

It also administers the Public Debt Program and the Fiscal Transfer Payments Program under the Federal-Provincial Fiscal Arrangements and Federal Post-Secondary Education and *Health Contributions Act*.

Savings from Program Review will be generated from:

- continued efficiency improvements;
- reductions of operations in various areas associated with the new Expenditure Management System; and
- introducing cost-recovery measures to recover some of the costs of the federal budget.

The Department of Finance operating spending will decline by $16 million over the next three years.

Finance

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings[1]		3	6	9
Authorized spending level[2]	67	62	56	51

[1] Excludes expenditures which are part of the International Assistance Envelope.

[2] Excludes the budget of agencies such as the Office of the Superintendant of Financial Institutions and the Canadian International Trade Tribunal.

Public Service Commission of Canada

The Public Service Commission of Canada (PSC) is a politically independent agency accountable to Parliament for the administration of the *Public Service Employment Act*. The PSC is responsible for ensuring that the federal Public Service is staffed with qualified persons in keeping with the merit principle. It also administers programs dealing with staff development, language training, personnel management audits, appeals and investigations related to personnel matters, counselling and career development and manages the Management Trainee and Special Measures Initiative (Employment Equity) Programs.

The Public Service Commission will implement a variety of efficiency improvements and streamlining measures which will reduce expenditures by $25 million over the next three years.

Public Service Commission of Canada

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings		4	11	14
Authorized spending level	129	123	113	104

Office of the Auditor General of Canada

The Office of the Auditor General of Canada audits the operations of federal government departments, agencies and Crown corporations and reports the results of these audits to Parliament. These audits make available to Members of Parliament information to help them examine the government's activities and hold it to account. The audits generally indicate whether the government is keeping proper accounts and records and presenting its financial information accurately and fairly, whether monies are spent for the purposes intended by Parliament and whether the programs were run economically and efficiently.

The Office of the Auditor General of Canada will introduce economies in support services and reduce value-for-money audits, thereby reducing expenditures $7 million over the next three years.

Office of the Auditor General of Canada

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings		2	2	4
Authorized spending level	57	53	52	50

Statistics Canada

Statistics Canada's mandate is to provide statistical information and analysis of the economic and social structure of Canada to assist policy development, planning and evaluation in both the public and private sectors. The Agency also promotes the quality, consistency and international comparability of Canada's statistical system.

As a result of Program Review Statistics Canada will implement:

- cuts in the frequency of certain programs; and
- operational and administrative streamlining.

Funding for Statistics Canada will decline by $23 million over the next three years.

Statistics Canada

	1994-95	1995-96	1996-97	1997-98
		(millions of dollars)		
Total budgetary savings		6	9	13
Authorized spending level	283	288	406[1]	260

[1] Includes funding increase for 1996 Census.

Annex 1

The review of forecasting accuracy and methods

In previous budgets, there were often substantial discrepancies between the actual and forecast outcomes for key economic variables. This contributed to errors in the fiscal forecast. The government, believing that good forecasts lead to increased credibility and better policies, commissioned Ernst & Young, a private sector consulting firm, to review the Department of Finance's forecasting methodology and accuracy.

The review was intended to answer two key questions:

- How accurate have the department's economic and fiscal forecasts been over the past decade?
- How could the department's forecasting accuracy be improved?

Ernst & Young concluded that the department's economic forecasts were more accurate than any individual private forecast, as well as the forecasts of the IMF and the OECD, on average over the 1982-83 to 1992-93 period. Despite this good performance relative to other forecasters, Ernst & Young found that the department made substantial errors in individual years, particularly at turning points in the business cycle. With respect to the fiscal forecast, Ernst & Young noted a tendency to overestimate revenues, and hence to underestimate the deficit over the period reviewed.

Ernst & Young identified a broad range of factors that impinged on the accuracy of the economic and fiscal forecasts. In all, they made 29 recommendations that could result in improved

forecasting performance. Half of these recommendations have already been implemented and have influenced the development of the fiscal planning assumptions in this budget. These include publication of the *Economic and Fiscal Update* document and seeking the views of Canadians on the appropriate economic assumptions.

Ernst & Young also recommended that the government present medium-term forecasts in the budget. The government believes that in the past this practice made it possible to postpone needed action. Short-term targets, in contrast, force the government to make continuous progress by increasing transparency and accountability. Consequently, the government will continue setting two-year deficit targets, extending the specific goals by one year in each budget.

The remaining recommendations, most of which involve Revenue Canada and Statistics Canada and their working relations with the Department of Finance, are under review. Many of these recommendations will be implemented soon. The department will also put in the public domain within a year the model used in preparing the economic forecast. This will facilitate an external evaluation of the model, as recommended by Ernst & Young.

Annex 2

The government's response to the main recommendations of the 1994 Report of the Auditor General

The 1994 Report of the Auditor General comprises 34 chapters of detailed information on selected government programs in over a dozen departments and agencies. Numerous observations, suggestions and recommendations are provided on these programs. Four areas were chosen for particular attention in this year's report:

- strengthening the performance of the tax system;
- finding savings through better management of federal programs and national assets such as real property;
- better management of investments in research and development; and
- continuing to eliminate overlap and duplication with the provinces.

Reduced fiscal manoeuvrability is the overriding reality that the government faces today. This was an important force behind the fundamental re-examination of government spending which was conducted under Program Review. The task of finding more

efficient and effective ways to deliver government programs is an ongoing one. In this context, the government welcomes the comments and recommendations of the Auditor General.

The government is examining every aspect of the report, with particular attention to implementing its recommendations. The following outlines the government's response to date on its key recommendations. Further consideration of the report will result in additional responses in the areas identified.

Strengthening the Performance of the Tax System

The Auditor General has chosen this area for special attention in his report. He states that action is required to safeguard the tax base and to prevent the erosion of federal revenues. The vast majority of taxpayers comply with the tax laws; however, some do not. Non-compliance with tax law results in lower tax revenues and undermines the government's ability to fund programs and service the public debt. The integrity and fairness of the tax system depends on all Canadians paying the tax they owe.

Specifically, the Auditor General refers to the need for effective tax collection practices and for appropriate enforcement strategies that will improve detection and action against those not complying with the tax laws. This budget proposes the following actions aimed at ensuring that taxes are paid on time and that Revenue Canada's ability to enforce compliance is improved:

- increasing the interest rate on unpaid income taxes;
- enhanced reporting requirements in respect of payments made within the construction industry;
- new reporting requirements for foreign investments including foreign trusts;
- improving Revenue Canada's ability to require production of information on third parties in order to verify compliance;
- improving Revenue Canada's approach to the audit of large business; and
- tightening the rules with respect to the remittance of source deductions and GST.

In addition, Revenue Canada has taken a number of steps to address the concerns expressed by the Auditor General:

- consolidating taxation and excise/GST collections programs and implementing joint income tax/GST audits;
- achieving efficiencies through exchanges and sharing of client information, integrated collections actions and computer cross-references and links;
- establishing a Compliance Research Division in Revenue Canada to better identify non-compliance and ways to improve compliance; and
- implementing a communications strategy under which prosecutions and convictions are publicized in order to deter non-compliance.

The Auditor General also noted that customs officers were overburdened and that there was a consequent loss of customs revenue. In response, Revenue Canada is undertaking a fundamental re-engineering of Customs' commercial operations to redesign the relationship with clients. Further, it is moving to more self-assessment which puts greater responsibility on the importer.

Finally, the Auditor General commented on the need for better monitoring and reporting on the performance and results of the tax expenditures on research and development and on retirement savings. With regard to research and development, a Revenue Canada–Department of Finance working group has been established to improve the information flow between the departments. In addition, as noted above, a joint Finance–Revenue Canada evaluation of the scientific research and experimental development tax incentives is underway and the results will be published once this work is complete. Similarly, an evaluation of the 1991 reforms to the tax assistance for retirement savings is also being undertaken and the results of this study will also be published.

Better Management of Government Programs

Cyclical audits are performed by the Auditor General on major departments and agencies. Problems and rigidities in the structure of programs and their delivery are highlighted and opportunities for savings are indicated in his annual report.

On the subject of health and safety, the Auditor General notes that the food-related provisions of the *Food and Drug Act* are not being applied fully and effectively to all food produced domestically or imported. In response, Health Canada is improving the effectiveness and cost efficiency of the federal component of the Canadian food inspection system, including possible organizational changes, in co-operation with other departments and in consultation with the industry and the provinces. Fisheries and Oceans is also amending its inspection policy to place increased emphasis on risk, seasonality of operations and volume of production.

In response to the Auditor General's comment on the need to update regulation of the nuclear industry, the Atomic Energy Control Board is currently examining ways to modernize the *Atomic Energy Control Act*. In addition, the nuclear regulatory framework is being strengthened by modernizing existing regulations and redeveloping compliance and enforcement procedures and criteria.

Comments by the Auditor General on the need to improve safety to the public and Correctional Services' staff have prompted a number of actions by Correctional Services Canada. Improved information on offenders is now being developed to assist in management of risks and costs of initial and ongoing penitentiary placements. Risk assessment training is being provided to staff and improvements are being made to ways to identify potential violent offenders. As well, a senior advisor has been appointed to manage improvements in the area of supervising offenders released to the community.

In a related area, the Auditor General noted that improvements were required in the selection and performance of National Parole Board members. The National Parole Board has taken a number of actions in response. The selection criteria of board members now emphasizes knowledge and experience of the criminal justice system. Vacancies on the board are advertised in the Canada Gazette. Training for board members has been enhanced and performance criteria for annual appraisals of board members have been initiated.

The area of management of the government's real property assets prompted a number of observations and recommendations. The Auditor General notes that while major initiatives have been undertaken by the government to improve real property management practices, there is still much room for improvement. In

response, Treasury Board Secretariat has taken steps to strengthen and integrate real property information systems and improve the content and review processes for long-term capital plans. The government is also assessing the feasibility of creating a new corporation or using an existing one to manage and dispose of surplus federal property.

In its role as the largest administrator of property in the country, National Defence has increased the use of business case methodology to determine optimal infrastructure management practices. It is preparing business plans to rationalize current and projected backlogs of infrastructure projects. In response to a particular concern raised by the Auditor General, a special operating agency for the Canadian Forces Housing Agency has been created to rationalize family housing operations and eliminate its deficit.

Other concerns relating to National Defence programs were raised by the Auditor General. He noted that improvements to the management of National Defence's information technology projects were required. In response, National Defence has created a Defence Information Services Organization which will be responsible for identifying cost reductions and effectiveness improvements in this area. It is also undertaking a complete review of the Defence Program Management System and has combined a number of functions into one directorate with responsibility to direct projects from acceptance through to delivery. This should reduce risk and streamline procurement.

Lack of compliance with Treasury Board's policy on cost recovery of federal food inspection services was noted by the Auditor General. In response, the departments concerned (Agriculture and Agri-Foods Canada, Fisheries and Oceans and Treasury Board Secretariat) are investigating opportunities for cost recovery of various inspection services. A co-ordinated and consistent approach to all industries among departments is being developed. The departments are negotiating and consulting with various sectors of the food industry on cost recovery. Proposed regulations are being prepublished to allow for cost recovery for some services.

The need for more cost effective management of Foreign Affairs and International Trade programs was raised by the Auditor General. The department has responded by implementing initiatives which will contribute to maintaining better control and obtaining better value for money including improved recruiting, training and

increased audits of missions. Further, the Physical Resources Bureau has been converted to a special operating agency which will lead to a sound business plan and extensive improvements in operations.

The Environmental Partners Fund of Environment Canada was noted by the Auditor General for failure to demonstrate whether it has achieved its intended results. In response, the department has taken steps to ensure that adequate information is provided to measure program results. Departmental internal audit and program evaluation have measured progress in key program areas and adjustments have been made to enhance program effectiveness.

A recurring theme of the Auditor General's Reports – the need for improved information for Parliament and decision makers – was raised in the context of several programs. Three are noted here. First, regarding information on Canada's social programs generally, including their effectiveness, efficiency and possible negative effects on the economy, the Minister of Human Resources Development has issued a comprehensive discussion paper entitled *Improving Social Security in Canada* and a series of related background papers which provided detailed information on social programs, reviewed their impact on the economy, assessed the need for reform and suggested how these reforms might be achieved.

Second, additional information on social assistance payments to Indians was raised by the Auditor General. In response, Indian Affairs and Northern Development has improved the management and accountability of the program, including the integrity of its social assistance data collection.

Third, the Auditor General expressed concern that farm safety net programs are unco-ordinated and have a fragmented approach within the industry. He notes that there is a need to co-ordinate the various farm income support programs to achieve an agreed objective. Agriculture and Agri-Food Canada is responding by developing a "whole farm" approach to income support.

It should be noted that in response to comments made in previous reports of the Auditor General on the need for improved information to Parliament, the government has implemented numerous changes. These include publication of an *Annual Financial Report*, improvements in the presentation and information contained in the *Public Accounts of Canada* and providing access to the Library of Parliament on highlights of internal departmental audits and program evaluations.

Better Management of Science and Technology Investments

Research and development is an important tool in moving Canada from a resource-based economy to one based on meeting consumer demands in the future. The government has recognized this. Federal programs spend some $6 billion annually in support of research and development and another $1 billion in tax incentives.

The Auditor General, echoing several other studies, including a recent announcement by the National Advisory Board on Science and Technology (NABST), notes, however, that there continues to be an absence of strong leadership in this area of spending and that the government has no clear idea of precisely what it is trying to achieve.

In response, Industry Canada is developing a federal science and technology strategy. The department is drafting a national vision of science and technology through external consultations, an internal review as well as an independent assessment by the NABST.

Industry Canada, in conjunction with other relevant departments, is also working to increase the relevance and economic impact of the government's science and technology spending. A more business-like approach is being adopted.

Elimination of Overlap and Duplication

The Auditor General notes that in his opinion, it is neither feasible nor desirable to eliminate all overlap among different levels of government. The scale and complexity of modern governments no longer permits a clear separation of powers.

Having said this, today's restrictive fiscal environment requires every effort to avoid overlap that results in unnecessary costs to governments and the private sector. Much of federal overlap with the provinces has been eliminated but more can be done.

Food inspection activities are a case in point noted by the Auditor General. The blueprint for a more integrated food inspection system being developed among federal departments and the provinces will harmonize national standards and create a single contact system for food inspection in Canada.

Further, a Memorandum of Understanding with the provinces has clarified respective roles in this area. In fisheries, discussions are to be held with U.S. counterparts to improve co-ordination and coverage of third country imports.

The Auditor General also states that the roles and responsibilities of federal and provincial agencies responsible for regulating the nuclear industry need clarification. In response, the Atomic Energy Control Board is committed to review and strengthen co-operation of the regulatory process among federal and provincial departments. New legislation to facilitate development of improved co-operative arrangements will be proposed. It will eliminate gaps, overlap and multiple jurisdiction problems.

Annex 3

Task Force on Economic Instruments

Introduction

In the 1994 budget, the government stated it would create a multi-stakeholder task force to provide advice on measures to ensure that environmental issues are integrated into economic decision-making. The Task Force on Economic Instruments and Disincentives to Sound Environmental Practices submitted its report to the Ministers of Finance and the Environment on November 30, 1994. The report included short-term proposals for immediate consideration and advice on longer-term initiatives.

The government will formally respond to the Task Force report in the coming months. In addition, it will announce the process that it intends to follow, including involvement of stakeholders, for dealing with the longer-term recommendations coming from the Task Force. The budget responds directly to a number of the Task Force's short-term proposals.

Energy Efficient Mortgages and Energy Retrofits – Enhanced Financing

The financial community can play an important role in facilitating sound environmental practices. Energy efficient homes with R2000 ratings and energy efficiency retrofits – for homes and businesses – can result in lower operating costs and in improved debt-servicing capacity of borrowers. The government brought these Task Force

proposals to the attention of the Canadian Bankers Association. It noted that banks have been active in this area and that potential energy savings are taken into consideration in extending loans.

Level Playing Field in the Energy Sector

In the 1994 budget, changes were made to the capital cost allowances for certain types of energy conservation equipment to assist newer, cleaner technologies such as geothermal and photovoltaics. To further this initiative, the Department of Finance will continue to review the tax system to determine whether the current income tax treatment of energy efficiency, renewable energy and non-renewable energy investments is appropriate and if there are further improvements that can be made.

Federal Government Operations

The Task Force supported a leadership role for the government and recommended a high priority be attached to the continued greening of government operations. The Minister of the Environment is developing with her Cabinet colleagues a proposal to move forward, within the ambit of federal operations, on conserving energy and water, reducing waste and procurement of environmentally friendly products. This initiative will support and strengthen ongoing efforts of business and industry to promote environmentally and economically sound management practices in Canada.

Agriculture Canada Programs

Agriculture and Agri-Food Canada (AAFC) provides financial support to the recently created National Agriculture Environment Committee (NAEC). The Committee and its member farm organizations are developing proactive strategies based on environmentally sustainable farming practices. Many of the initiatives funded under the Green Plan's Sustainable Agriculture Initiative have been instrumental in assisting farmers to adopt sustainable practices, such as no-till seeding and preparation of environmental farm plans. AAFC is also moving in the direction of more whole-system research to assist the sector to adopt more environmentally sustainable forms of production.

Land Donations for Conservation

Canadians who donate ecologically sensitive land for conservation purposes may claim a federal tax credit of 29 per cent (on donations exceeding $200). When provincial income taxes and surtaxes are taken into account, this credit can provide Canadians with tax savings equal to about 50¢ per dollar donated.

When the land is donated to an environmental charity or municipalities, the amount claimed for the donation credit is limited to 20 per cent of an individual's (or corporation's) net income in a year. In both cases, donors are able to carry unused claims forward for up to five years, which helps them to claim the full amount of most donations. However, donations of ecologically sensitive land sometimes exceed the 20-per-cent limit, even after the five-year carry-forward is taken into account. Therefore, the budget proposes to exempt donations of ecologically sensitive land for conservation purposes from the 20 per cent of income limit. This proposed measure will help to encourage Canadians to participate in preserving our ecological heritage.

Duties on Imported Pollution Control Equipment

In many cases, pollution control equipment can already be imported free of duty. However, in specific instances the tariff on dutiable pollution control equipment may represent a significant cost to users and act as a disincentive to acquiring the equipment. The government will review specific requests it receives for tariff relief by importers of pollution control equipment in light of these and other relevant economic factors.

Recycled Material

As part of its ongoing responsibilities to monitor the environmental implications of the tax system, the Department of Finance will examine whether the income and sales tax systems contain any barriers and disincentives to the use of recycled material and will consider options for their reduction where appropriate.

Annex 4

Canada–United States fiscal comparison

Introduction and Overview

Comparisons are often made between Canada's fiscal situation and that of other countries.

One problem with many international fiscal comparisons is that measures may be used which are not comparable across countries due to differences in accounting practices.

Although it is possible to use either public accounts or national accounts data when making international comparisons, it is necessary to ensure that the measures being used are comparable.

For example, when comparing the Canadian fiscal situation with that of the United States on a public accounts basis, Canada's federal government financial requirements (as opposed to the federal government public accounts deficit) should be compared with the unified budget basis (UBB) deficit of the U.S. government.

Comparisons with the United States are particularly important for Canada, reflecting the importance of the U.S. economy to Canada and, in particular, the high degree of financial integration between the two.

Accordingly, the following charts present Canada–U.S. fiscal comparisons using comparable measures for federal government deficits, program spending and operating balances.

The charts show that Canada is set to achieve a superior fiscal performance compared with the United States in the near term. As a result of our stronger effort to cut program spending, we will achieve larger improvements in both our budgetary and operating balances relative to the United States.

Our Deficit-to-GDP Ratio Improves Rapidly Relative to that of the United States...

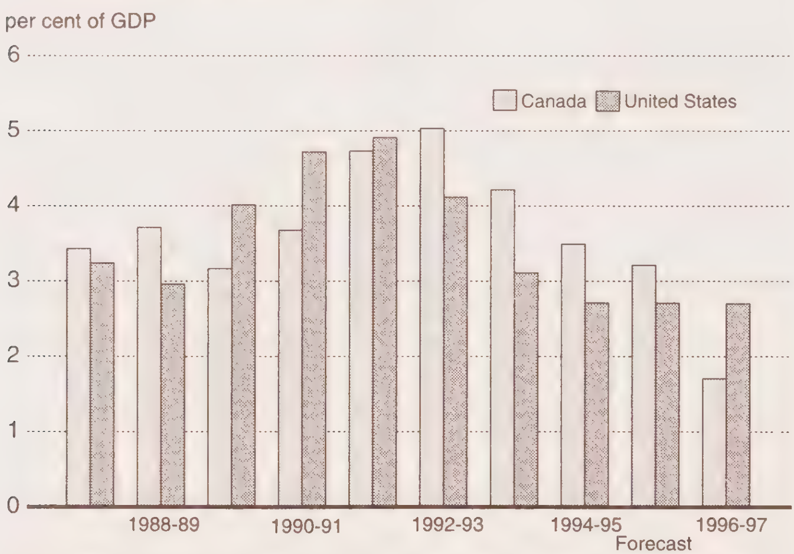
Defined on a comparable basis, Canadian federal deficits have been larger than U.S. government deficits as a share of GDP in recent years. As a result, Canada has a much larger debt-to-GDP ratio than in the United States. Getting the debt under control requires that Canadian deficits fall sharply.

With the measures proposed in this budget, Canada's federal deficit will decline sharply.

By 1996-97, Canada's federal deficit as a share of GDP will be significantly lower than that of the U.S. government.

Chart 4.1

Federal government deficits in Canada and the United States



Notes: Financial requirements for Canada and the Unified Budget Basis (UBB) deficit for the United States.
Fiscal years ending March 31 and September 30 of the same year for Canada and the U.S. respectively.

Sources: Canada, Department of Finance Canada; United States, Department of Commerce and *Budget of the United States Government, Fiscal Year 1996.*

Furthermore, this budget's measures will continue to generate deficit reductions beyond 1996-97, moving Canada toward the objective of a balanced federal budget.

...Because Program Spending Declines Relatively More

The share of Canada's federal program spending to GDP is set to fall significantly faster than that in the U.S.

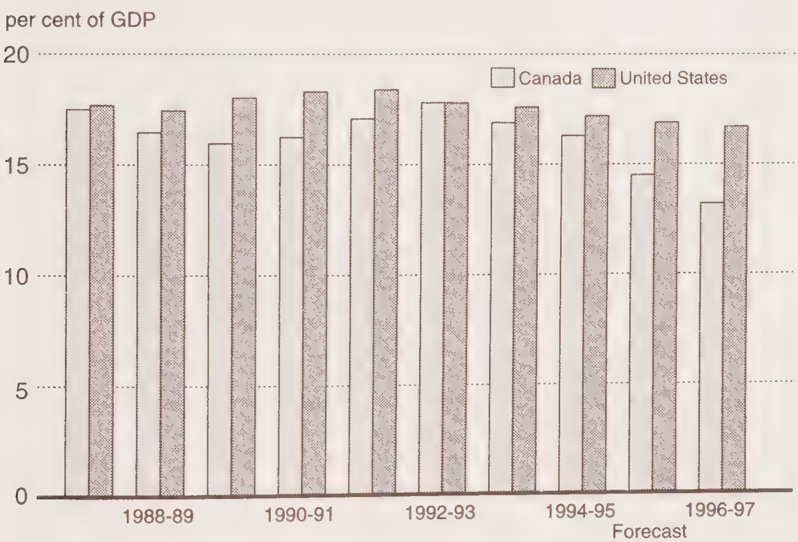
This is the main reason behind our better prospective deficit reduction performance compared to the United States.

In Canada, federal program spending will decline by more than 3.5 percentage points in the near term to reach 13.2 per cent of GDP in 1996-97.

In contrast, the ratio of program spending to GDP in the U.S. will fall by only 0.9 percentage points to reach 16.7 per cent of GDP in 1996-97.

Chart 4.2

Federal government program expenditure



Notes: Total expenditure minus gross debt service charges for Canada and the U.S.

Fiscal years ending March 31 and September 30 of the same year for Canada and the U.S. respectively.

Sources: Canada, Department of Finance Canada; United States, Department of Commerce and *Budget of the United States Government, Fiscal Year 1996.*

Engendering a Stronger Improvement in our Operating Balance Relative to the United States

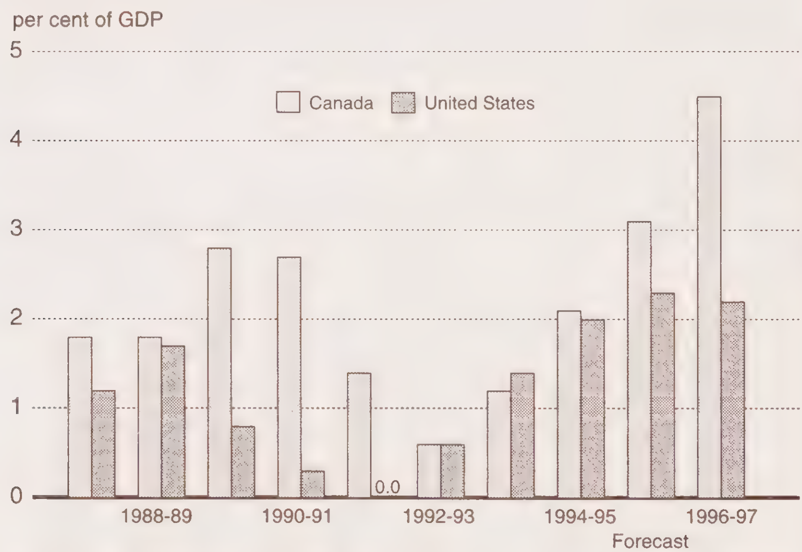
As a result of our determined program spending cuts, Canada's federal operating balance – total revenues less program spending – as a share of GDP is also set to improve relative to that of the U.S. government in the near term.

In 1996-97, Canada's federal operating surplus is forecast to reach 4.6 per cent of GDP, more than twice the size of that in the U.S.

Operating surpluses provide needed funds to pay interest on, and ultimately reduce, our debt.

Chart 4.3

Federal government operating balances



Notes: Financial requirements less gross debt service payments for Canada and the Unified Budget Basis(UBB) deficit less gross debt service payments for the United States.

Fiscal years ending March 31 and September 30 of the same year for Canada and the U.S. respectively.

Sources: Canada, Department of Finance Canada; United States, Department of Commerce *Budget of the United States Government, Fiscal Year 1996.*

Annex 5

The Spending Control Act

Compliance with the Spending Control Act

Under the *Spending Control Act*, the government must indicate how the current spending projections comply with the spending limits set out in the Act. The *Spending Control Act* covers all program spending, comprised of total budgetary expenditures less public debt charges, with the exception of expenditures related to a limited number of self-financing programs. Actual and projected spending over the 1991-92 to 1995-96 period cannot exceed the limits set out in the Act.

Actual spending subject to control, as audited by the Auditor General of Canada, for the first three years of the *Spending Control Act* was $4.6 billion below the aggregate spending control limits for these years.

Over the remaining period covered by the Act, spending subject to control is projected to be well below the spending limits for these years. Spending subject to control in 1994-95 is projected to be $2.7 billion below the limit for that year, while spending subject to control in 1995-96 is projected to be $12.7 billion below the limit for that year. The much lower spending in these years reflects the impact of the fiscal actions proposed in this budget as well as the actions taken in previous budgets.

Table A5.1
Compliance with the Spending Control Act

	1991-92	1992-93	1993-94	1994-95	1995-96
			(billions of dollars)		
A. *Spending Control Act*					
Original limits	97.2	100.9	104.1	103.4	111.3
Expenditures justified by current/future years' increase in revenues[1]		0.1	0.1	0.1	0.1
Allocating of overspending[2]	-0.6	0.6			
Adjusted spending limits	96.7	101.6	104.1	107.4	111.2
B. February 1995 budget					
Program spending[3]	115.2	122.6	120.0	121.3	114.0
Less:					
Expenditure under the *Unemployment Insurance Act*	19.3	20.3	18.9	16.6	15.5
Expenditures under the *Farm Income Protection Act*	0.1	0.1	0.4		
Expenditures relating to events occurring prior to April 1, 1991	0.2	0.6	0.1		
Program spending subject to spending limit	95.6	101.6	100.7	104.7	98.5
C. Excess (+) or underspending (-)	-1.1	0.0	-3.5	-2.7	-12.7

[1] Pursuant to Section 4 of the *Spending Control Act*, the spending limit for a fiscal year can be modified. In compliance with this section, the President of the Treasury Board may certify that a proposed increase in expenditures for a specific program is justified by reasons of good management. This situation applies only when an increase in expenditures results in an equivalent increase in revenues that would not otherwise occur.

[2] Where program spending exceeds the spending limit for a fiscal year, the excess must be offset through reduced spending in the following two years. Where the spending limit for a fiscal year exceeds program spending, the Minister of Finance may partially or fully allocate the excess to a subsequent fiscal year. In the February 1994 budget, the Minister of Finance allocated part of the 1991-92 underspending ($1,625 million) to cover the excess spending of 1992-93 ($579 million). As a result, the spending limit for 1991-92 was lowered to $96,621 million, while the limit for 1992-93 was raised to $101,479 million.

[3] Data for 1991-92, 1992-93, and 1993-94 are final results as audited by the Auditor General of Canada and reported in the *Public Accounts of Canada*.

The *Spending Control Act* required that the government make a recommendation in the 1994 budget, as to whether or not the *Spending Control Act* should be extended beyond 1995-96. In that budget, the government indicated that it would adhere to the spending limits set out in the current legislation. The government also indicated that it would not be recommending the extension of the *Spending Control Act* beyond 1995-96. Given that spending subject to control is significantly below the spending limits set out in the legislation, extension of this Act is clearly not required to demonstrate control over government spending.

Annex 6

Tax measures: supplementary information and Notices of Ways and Means Motions

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Tax Measures: Supplementary Information

The government is aware of the heavy tax burden already borne by Canadians and the costs this imposes on the economy as a whole. Accordingly, personal tax rates are not being raised. Nevertheless, the budget proposes a number of changes to tighten the administration of the tax system, to remove or reduce a number of tax preferences, to increase fairness in the tax system and to further ensure that taxpayors pay the taxes they owe, when they are due.

Table 6.1
Federal revenue impact of tax measures

	1995-96	1996-97	1997-98
		(millions of dollars)	
Measures to increase fairness and tighten the tax system			
Reduce RPP and RRSP limits to $13,500	15	70	115
Reduce $8,000 RRSP overcontribution	–	10	10
Phase out retiring allowance rollover	–	15	35
Strengthen Revenue Canada's ability to enforce the law	Prevents revenue losses		
Additional tax on investment income of private corporations	40	120	120
Eliminate deferral of tax on business income	–	170	300
Restrict SR&ED tax incentives	–	15	15
Family trusts	Prevents revenue losses		
Re-targeted film incentive	small	small	small
Subtotal	55	400	595
Increases in tax rates			
Corporate			
Large corporations tax	145	155	160
Corporate surtax	115	115	120
Temporary capital tax increase for large deposit-taking institutions	60	40	–
Excise			
Tobacco	65	65	65
Gasoline	500	500	500
Subtotal	885	875	845
Total	940	1275	1440

To help meet the deficit reduction targets, tax rates on the corporate sector, and in particular on large corporations and deposit-taking institutions, are being increased. Also in support of meeting the deficit targets, the excise tax on gasoline is being increased. Finally, an increase in the excise taxes on cigarettes was announced on February 17, 1995.

The government will be continuing to review the tax system to ensure that it is fair and does not impede the ability of the Canadian economy to grow in an increasingly competitive global environment. Although some tax rates have been increased in this budget to meet deficit reduction targets, the government's ultimate goal is to have lower tax rates in Canada.

Measures to Increase Fairness and Tighten the Tax System

Measures Relating to Retirement Saving

The budget proposes three measures relating to the limits on saving in registered pension plans (RPPs), deferred profit sharing plans (DPSPs), and registered retirement savings plans (RRSPs). They are: a reduction in the contribution limits for RRSPs and money purchase RPPs, a reduction in the $8,000 allowance for overcontributions to RRSPs and the phase-out of tax-free rollovers of retiring allowances to RRSPs.

The first of these measures will provide fiscal savings while affecting only individuals earning over $75,000. The second will substantially eliminate an opportunity for unintended tax deferrals. The third will phase out a measure which is no longer needed under the new system of pension and RRSP limits.

In conjunction with these measures, the government proposes to investigate the possibility of modifying the RRSP limits, without incurring additional revenue costs, to restore lost RRSP room to employees who terminate their membership in pension plans before retirement. The Department of Finance will consult with pension plan sponsors and employee groups on this matter later in the year.

Reduction in Pension and RRSP Contribution Limits

The budget proposes to reduce the contribution limit for RRSPs to $13,500 in 1996. The contribution limit for money purchase RPPs will also be reduced to $13,500. These limits will be increased beginning in 1997 according to the schedule set out in the table below. This measure will produce fiscal savings and will adjust the limits to a level where full tax assistance is provided on earnings up to about 2.5 times the average wage, the target set under pension reform.

Table 6.2
Dollar limits on contributions to RPPs and RRSPs

	RPPs		RRSPs	
	Existing	Modified	Existing	Modified
1995	$15,500	$15,500	$14,500	$14,500
1996	Indexed	$13,500	$15,500	$13,500
1997		$14,500	Indexed	$13,500
1998		$15,500		$14,500
1999		Indexed		$15,500
2000				Indexed

Notes: [1] The RPP amounts are for money purchase plans. The dollar limits on contributions to deferred profit sharing plans will remain at one-half the dollar limits on RPP contributions.

[2] To ensure that benefits under defined benefit pension plans are limited in a manner that is consistent with the treatment of contributions to money purchase plans, the indexing of the maximum pension limit of $1,722 per year of service will be deferred to 1999 rather than beginning in 1996.

[3] There will be no modification to the rules for determining pension adjustments under defined benefit pension plans during the period of reduced RRSP limits.

Reduction in the $8,000 RRSP Overcontribution Allowance

To control unintended tax deferrals, the *Income Tax Act* imposes a penalty tax of 1 per cent per month on excess contributions to RRSPs. In determining the amount of this tax, an allowance of $8,000 of excess contributions is provided.

The $8,000 allowance was intended to provide a margin of error for overcontributions arising through inadvertence or through the operation of group RRSP arrangements. However, it is now apparent that taxpayers often use the $8,000 allowance to make deliberate overcontributions.

This budget proposes to reduce the allowance to $2,000, starting in January 1996, and introduce the following changes:

- for a taxpayer with excess contributions on February 26, 1995, there will be an additional allowance after 1995 that will serve to phase in the reduction to $2,000. This additional allowance will be reduced each year by the amount of new RRSP room that becomes available to the taxpayer in the year. This will allow existing excess contributions to be retained until they can be deducted against new RRSP room, rather than forcing them to be withdrawn;
- non-discretionary contributions to group RRSPs based on current year earnings will be accommodated by not being taken into account for penalty tax purposes until after the end of the year in which they are made;
- past service pension adjustments (PSPAs) will not be taken into account for penalty tax purposes in the year in which they are reported. This will ensure that RRSP contributions that become excess contributions because of a PSPA do not attract penalty tax in the year the PSPA is reported.

Phase-Out of Retiring Allowance Rollovers

Currently, individuals who receive payments on termination from employment in respect of long service may transfer to an RRSP up to $2,000 for each year of service plus up to $1,500 for each year before 1989 in which they earned no pension or DPSP benefits. This is in addition to the normal limits for RRSP contributions. The rationale for this measure has been eliminated by the maturation of pension plans, the increase in RRSP limits for those not in pension plans, and the ability to carry forward unused RRSP limits. The budget proposes to eliminate this rollover in respect of years of service after 1995. Individuals may continue to transfer up to $2,000 per year of service before 1996, plus $1,500 for each year before 1989 in which they earned no pension or DPSP benefits.

Strengthen Revenue Canada's Ability to Enforce the Law

Over the past year, Revenue Canada has taken a number of initiatives to strengthen its enforcement of the tax laws. These have included:

- devoting increased resources to identifying areas of high non-compliance, such as home renovation, construction, auto sales, restaurants, jewelry and other service sectors;
- enhanced measures to detect non-filers and non-registrants;
- co-operative arrangements with provinces to share information and to conduct joint audits; and
- working with business and professional associations.

These efforts have delivered concrete results. Revenue Canada's underground economy initiative, which began in November 1993, is expected to add close to a billion dollars in assessed taxes by the end of 1994-95.

Building on these initiatives, the budget proposes a number of measures aimed at improving Revenue Canada's ability to enforce compliance with the law.

Reporting Payments in the Construction Industry

The budget proposes that a new information reporting system be introduced to require certain payments made after 1995 within the construction industry to be reported to Revenue Canada. The payments to be reported will be those made to or on behalf of a person for the provision of goods and services in the course of activities related to the construction, alteration, repair or removal of any structure by that person. Reporting will be required only where the payment is made by a person in a construction business.

Subcontracting in the construction industry has grown in response to business requirements for greater flexibility and control over projects. This has led to a move away from employer-employee relationships and contributed to increased tax compliance problems in the industry. Unlike payments to employees, there is no existing requirement to report to Revenue Canada payments made to subcontractors.

Revenue Canada's stepped up enforcement efforts in the construction sector and industry representations have indicated a relatively high level of non-compliance, particularly with respect to the reporting of income. As well, in consultations with construction industry associations over the past year, firms in the home building industry have expressed their frustration at the difficulties in competing with businesses that operate within the underground economy, often by contracting work out "under the table".

Revenue Canada will consult with the construction industry to develop a system of reporting which minimizes the compliance burden on payers while providing the information necessary to verify compliance with the tax laws. The Minister of National Revenue will announce details of these consultations shortly.

Reporting of Ownership of Interests in Foreign Properties

The budget proposes that Canadian individuals and corporations who hold or acquire investments outside Canada be required to disclose additional information regarding their interests in such investments. These new requirements will provide Revenue Canada with additional information regarding offshore investment made by Canadians, will allow a more efficient administration of the *Income Tax Act* and will help ensure that Canadian individuals and corporations pay an appropriate amount of Canadian tax on income accruing with respect to their foreign holdings. The new reporting requirements will be effective for taxation years commencing after 1995.

Under the proposed requirements, the types of additional information the government will be seeking will include:

- details of certain transfers to, or deposits with, a foreign corporation, partnership, trust or estate;
- the name of, and equity percentage in, each foreign affiliate of a resident individual;
- information in respect of the income earned by a controlled foreign affiliate, including identification of the nature of the income which forms part of foreign accrual property income (FAPI) included in the income of the taxpayer in the year and the disclosure of whether income that would otherwise have been FAPI was considered to be income from an active business by virtue of specific provisions of the *Income Tax Act*; and

- an annual information return in respect of a non-resident trust to which money or property was transferred from an individual or a corporation resident in Canada or in respect of which a Canadian resident is a beneficiary; this information return will include the financial statements of the trust as well as information on contributions to and distributions from the trust.

Further details of these new requirements will be announced in the coming months and will be the subject of consultations with interested parties.

Improving Revenue Canada's Access to Third-Party Information

The *Income Tax Act* currently provides that a judge may authorize the Minister of National Revenue to order a person to produce information on unnamed persons for the purpose of verifying compliance with the Act.

The budget proposes that the Act be amended to empower a judge on application by the Minister to authorize an order for the disclosure of information where the judge is satisfied that the person or group in respect of which information is sought is ascertainable and that the information is to be used in verifying compliance with the Act. The judge authorizing the order would continue to exercise residual discretion, and to attach such conditions as are considered appropriate to the granting of the authorization. The budget proposes that similar amendments be made to the *Unemployment Insurance Act* and the Canada Pension Plan.

Under the current provisions, in order to authorize an order, a judge must be satisfied that based on statistical or other information, it is reasonable to expect that the person or any person in the group in respect of whom information is sought may have failed, or is likely to fail, to comply with the Act, and that the information is not otherwise more readily available. These restrictions, which make it difficult for Revenue Canada to obtain timely information in order to verify compliance with the Act, are being eliminated. This proposed measure will improve Revenue Canada's ability to verify compliance with the self-assessment system with respect to transactions where no information reporting is required.

This amendment is proposed to apply after Royal Assent to the implementing legislation.

Large Business Audit Initiative

In an increasingly complex business environment, it is important that Revenue Canada maintain the ability to audit the tax affairs of businesses, particularly large businesses.

The Minister of National Revenue will be introducing a new approach to the audit of large businesses. Revenue Canada will establish teams of specialists with the appropriate level of expertise to deal with the most complex audits. The government will ensure that Revenue Canada has adequate flexibility to staff these teams. In addition, Revenue Canada will be adapting its approach to the audit of large businesses to ensure that significant issues are identified and resolved in as timely a manner as possible.

The Minister of National Revenue will be providing further details of this initiative shortly.

Protecting Source Deductions and GST Payments

The budget proposes that new rules be introduced to protect the collection of amounts withheld at source and goods and services tax (GST).

Employers and other persons who pay salaries, wages and certain other payments are required to make deductions on account of the income tax, Canada Pension Plan contributions and unemployment insurance premiums payable by the recipients and remit the deductions to the Receiver General. Persons withholding these amounts hold them in trust until they are remitted. Since these amounts are withheld from the recipients on their behalf, the recipients are treated as having paid them, whether or not the withheld amounts are actually remitted to the Receiver General.

Given the importance of the source deduction system, the Act contains special provisions relating to their withholding and remittance:

- special penalties apply where a person fails to withhold or remit the required amounts;
- the directors of a corporation that fails to withhold or remit source deductions may be made personally liable to pay the amounts; and
- special rules provide for their collection in priority to other debts.

Recent instances have come to light where the collection of source deductions has been put at risk through the interference of third parties. For example, a financial institution that is a secured creditor of a taxpayer in financial difficulty may refuse to clear cheques to the Receiver General on account of source deductions, while continuing to honour cheques to employees and other creditors of the taxpayer. Typically, this type of interference with the remittance of source deductions occurs where the secured creditors are attempting to recoup their own losses at the expense of employees' unremitted source deductions.

In order to protect the payment of employee and other source deductions in these and similar circumstances, the budget proposes that certain secured creditors who have influence over the clearance or issuance of such payments and who interfere with the remittance of source deductions directly or by influencing taxpayers required to remit such amounts, will be liable to pay those source deductions, plus any applicable interest and penalties, in the same way that the taxpayers are liable. This new requirement stresses the need for compliance with the source deduction system and, in cases where this does not occur as a consequence of the interference of third parties, ensures a fair distribution of the losses related to unremitted source deductions.

A similar amendment to the *Excise Tax Act* is proposed for the purposes of the GST. The amendment will make certain secured creditors who have influence over the clearance or issuance of payments of net GST owing by a registrant, and who interfere with the remittance of that net tax, liable for the amount plus any applicable interest and penalties.

These amendments are proposed to apply after Royal Assent to the implementing legislation.

Additional Refundable Tax on Investment Income of Private Corporations

Under current rules, individuals earning investment income through Canadian-controlled private corporations (CCPCs) can obtain a tax deferral advantage compared to those who earn such income directly. The budget proposes to introduce an additional refundable tax of 6⅔ per cent on the investment income (other than deductible dividends) of Canadian-controlled private corporations to reduce this deferral advantage. This additional tax will be credited to the corporation's refundable dividend tax on hand (RDTOH).

The RDTOH pool will be refunded to the corporation, upon the payment of dividends to shareholders, at a rate of one dollar for every three dollars of taxable dividends paid. Both the new tax and the new refund rate will apply after June 30, 1995. The tax will be pro-rated for taxation years beginning before that date.

For this purpose, investment income includes interest, the taxable portion of capital gains, and other property income, but does not include deductible dividends or income from an investment business with more than five full-time employees.

This additional refundable tax addresses the same issue of tax deferral within a corporation as the increase in the refundable tax under Part IV of the *Income Tax Act* on portfolio dividends received by private corporations proposed in the 1994 federal budget. That proposal would have increased the Part IV tax rate from 25 per cent to 33⅓ per cent as of January 1, 1995.

To streamline and simplify the implementation of these two measures, the Part IV rate change planned for January 1, 1995 will be delayed until July 1, 1995. Thus, both measures will become effective on the same date. In addition, refunds of the paying corporation's RDTOH at the new rate of 1:3 will apply to all dividends paid after June 30, 1995, regardless of the rate at which that RDTOH was accumulated.

Background

The *Income Tax Act* contains a number of refundable tax provisions as part of an integrated system of measures that links the taxation of CCPCs and the individual taxation of their shareholders. The purpose of these measures is to ensure that the treatment of investment income earned directly by an individual is generally comparable to the treatment of investment income earned by a holding company and subsequently distributed to the individual as a taxable dividend.

In the case of portfolio dividend income received by a private corporation, an additional tax (Part IV) is levied on what would otherwise be a tax-free intercorporate dividend. Investment income (other than deductible dividends) earned by a corporation is

currently subject to the standard corporate tax rate, reflecting an assumption that this rate is approximately equal to the top personal tax rate. A portion of the corporate tax imposed on such income is refunded to a CCPC when taxable dividends are paid. The individual shareholder includes this dividend together with a gross-up amount in income and then receives a dividend tax credit in recognition of the corporate tax paid.

Operation of the RDTOH account

The RDTOH account of a private corporation accumulates two amounts:

- all of the Part IV tax paid by that corporation on its portfolio dividend income; and
- for CCPCs, up to 20 percentage points of the Part I tax paid on its investment income (other than deductible dividends) and taxable capital gains.

The corporation is then free to distribute taxable dividends out of both its retained earnings and this RDTOH account to the shareholder. Under the existing Act, the RDTOH amounts are refunded to the corporation at a rate of one dollar for every four dollars of total taxable dividend paid. Typically, this four dollars of taxable dividend would be comprised of three dollars from retained earnings and one dollar from the refund account itself.

In recent years the spread between corporate and personal income tax rates has generally increased. In several provinces, the top personal tax rate exceeds the top corporate rate by a significant amount. This creates an incentive for individuals to defer tax by accumulating investment income in a private corporation rather than earning the income directly.

By imposing an additional refundable tax of 6⅔ per cent on investment income earned by a CCPC, this proposal will reduce or eliminate the deferral advantage of earning investment income in the corporation as opposed to earning it directly. Because this additional tax will also be credited to the RDTOH account, the integration of the corporate and individual tax structures will be maintained. Corporations will now receive a refund of their RDTOH at a rate of one dollar for every three dollars of taxable dividends paid.

Table 6.3 illustrates the current tax deferral advantage for an individual in the top marginal tax rate bracket who flows interest income through a private holding corporation in contrast to earning this income directly. It also illustrates the impact of the additional refundable tax measure.

Table 6.3

Illustrative comparison of taxes paid on $100 of investment income earned by an individual directly, versus a private holding corporation

		Holding corporation	
	Individual	Current	Proposed
Investment Income	100.00	100.00	100.00
Federal tax	31.32	28.84	29.12[1]
Provincial tax [2]	20.00	15.50	15.50
Additional refundable tax	–	–	6.67
Total tax	51.32	44.34	51.29
After-tax income available for reinvestment	48.68	55.66	48.71
Deferral advantage in holding corporation	**n.a.**	**6.98**	**0.03**
Tax credited or paid on dividend distribution of $80 [3]			
Refundable Part I tax	n.a.	(20.00)	(20.00)
Additional refundable tax	n.a.	0.00	(6.67)
Total credits from RDTOH account		(20.00)	(26.67)
Additional personal income tax [4]	n.a.	27.00	27.00
Net additional tax		7.00	0.33

[1] This federal tax amount reflects the budget proposal to increase the corporate surtax rate from 3 to 4 per cent.

[2] Provincial personal income taxes on this income vary from $14.70 to $22.80. Provincial corporate income taxes on this income currently vary from $14 to $17.

[3] The corporation is assumed to have small amounts of other income that would allow it to pay an $80 dividend, and therefore fully utilize the refundable tax provisions.

[4] Additional personal income tax varies from $23.80 to $29.00 depending on the province.

Eliminating Deferral of Tax on Business Income

When calculating their income for tax purposes, individuals report salaries, wages and most other income earned during the relevant calendar year. On the other hand, they are required to report their business income on the basis of the fiscal period of their businesses. In calculating income for a calendar year, an individual must include income from any business with a fiscal period ending in that year. As a result, by selecting fiscal periods which end before December 31, individuals are able to delay the reporting of business income earned between the end of the business' fiscal period and December 31 and thereby defer the payment of tax on that income.

Deferral of business income for tax purposes – illustration

Consider an individual who is the sole owner of an unincorporated business that has a January 31 fiscal year-end. Under current income tax rules, the income earned by that business from February 1, 1994 to January 31, 1995 is reported in the individual's 1995 personal tax return (the tax return must be filed by April 30, 1996). As a consequence, the income earned between February 1 and December 31, 1994, which would be reported in the 1994 return if it were employment income, is reported in the 1995 return instead. In other words, the reporting of 11 months of business income and the payment of tax thereon is delayed for one year for tax purposes.

This budget proposes changes to improve the fairness of the tax system by eliminating the possibility of this delay in the reporting of business income and requiring unincorporated business owners to pay taxes on their income in the year in which the income is earned. Effective for fiscal periods beginning after 1994, all sole proprietorships, professional corporations and partnerships (where at least one member of the partnership is an individual, professional corporation or another affected partnership) will be required to have their fiscal periods end on December 31. For the purpose of this measure, a professional corporation is any corporation that carries on the professional practice of an accountant, dentist, lawyer, medical doctor, veterinarian or chiropractor.

Because most affected taxpayers would otherwise be required to report more than 12 months of business income in their 1995 income tax return, the measure includes provisions to bring the additional amounts into income over a 10-year transitional period – with 5 per cent of the additional income being included in 1995, 10 per cent being included in each of the subsequent eight years and 15 per cent being included in the last year. However, this transitional relief will not be available to taxpayers who report less than 12 months of business income in 1995 and will be restricted for those who discontinue or dispose of their business. In addition, the income eligible for transitional relief will be restricted in certain circumstances.

Illustration of transitional provision

Consider an individual with the following characteristics:

- the individual's unincorporated business earns $120,000 in each fiscal period; and
- the business has a January 31 year-end – the reporting of 11 months of income is deferred one year.

Income of $110,000, earned between February 1, 1995 and December 31, 1995, is currently deferred for tax purposes.

Calculation of business income for tax purposes

	1995	1996
Income from business		
Fiscal period ended January 31, 1995	$120,000	
Fiscal period ended December 31, 1996		$120,000
Inclusion of income that otherwise would have been deferred for tax purposes:		
Income earned between February 1, 1995 and December 31, 1995 – $110,000 (A)		
Annual inclusion percentage (B)	5 per cent	10 per cent
Additional income to be taxed (A x B)	5,500	11,000
Income from business to be reported	$125,500	$131,000

Because affected individuals will now have less time to prepare their financial statements and income tax returns, individuals (other than trusts) with business income (other than only from limited partnerships) will be given until June 15 of each year to complete and file their income tax returns. However, any tax owing will continue to be payable on April 30 and interest on unpaid taxes will be charged from that date. In addition, interest on tax refunds will continue to be payable commencing 45 days after the later of April 30 and the date the return is filed.

Those persons who will be required to have a December 31 fiscal year-end and who are registered for purposes of the GST will have the same year-end for GST purposes. This means that their last reporting period in 1995 will end on December 31 and subsequent reporting periods will be determined by reference to the calendar year. Revenue Canada will be providing further details regarding changes to reporting periods.

In addition, individuals who file annually for GST purposes, and whose filing deadline for income tax purposes is being extended to June 15, will benefit from the same extension with respect to their annual GST return. Any GST owing will still have to be paid by April 30.

Changes to Scientific Research and Experimental Development tax incentives

The federal government provides income tax incentives to encourage businesses to carry out scientific research and experimental development (SR&ED) in Canada. These income tax incentives are an integral component of the federal government's efforts to stimulate industrial R&D.

SR&ED tax incentives

Taxpayers carrying on eligible R&D in Canada are allowed to fully deduct all their qualifying current and capital expenditures in the year the expenditures are incurred or carry them forward to any subsequent year. In addition, these expenditures may earn investment tax credits (ITCs) of 20 per cent or 35 per cent. The higher rate credit is only available for smaller Canadian-controlled private corporations and, in many cases, this 35-per-cent credit is fully refundable. SR&ED is described in detail in Section 2900 of the Income Tax Regulations, as well as in Information Circular 86-4R3.

In general, eligible SR&ED can be described as work that involves technological uncertainty and advancement in a field of endeavour, that is carried out systematically by appropriately qualified people and that is:

- basic research;
- applied research; or
- experimental development.

The following work is not eligible SR&ED:

- research in the social sciences or humanities;
- commercial production of a new or improved material, device or product, or the commercial use of a new or improved process;
- style changes;
- market research or sales promotion; and
- quality control, routine testing or routine data collection.

Although the basic structure of these tax incentives has not changed since 1985, they have been closely monitored by the Department of Finance. During the last three years, several improvements were announced, many of which followed consultations with the R&D community. The improvements introduced a simpler method for determining eligible overhead costs (the proxy method), an extension of credits to previously ineligible equipment and a time limit for filing claims. As indicated in the Auditor General's 1994 report, Revenue Canada and the Department of Finance are undertaking a thorough evaluation of the SR&ED tax incentives.

The budget announces an accelerated review of the component of the evaluation dealing with information technology R&D. The budget also proposes a restriction on information technology SR&ED claims by financial institutions, pending the outcome of this review, as well as a number of other changes, primarily relating to contract R&D.

Information Technology R&D

R&D in the field of information technology (use of computer software and hardware to collect, process and disseminate information) has increased significantly in recent years. Currently, expenditures incurred in the field of information technology R&D may be eligible for SR&ED income tax incentives. Recently, concerns have been raised that the income tax rules have not kept pace with the rapid changes in this area. In response to these concerns, the government is accelerating its review of the income tax rules and administrative guidelines used to determine the eligibility of work performed in the area of information technology R&D. Revenue Canada is reviewing all SR&ED claims in this area, with a view to ensuring that the claims fully comply with the income tax law.

Concern has also been expressed with the ability of financial institutions to qualify for these income tax incentives on their information technology R&D. As an interim measure, the budget proposes that all information technology R&D performed after February 27, 1995 by financial institutions, either directly or indirectly, be excluded from the definition of SR&ED. For these purposes, financial institutions will include restricted financial institutions (as defined in subsection 248(1) of the *Income Tax Act*) as well as registered securities dealers. This restriction on the eligibility of information technology work will be in effect until the completion of the review of the eligibility criteria for information technology R&D. If the review concludes that all or part of the work excluded by this measure should have been eligible for the SR&ED incentives, such eligibility will be effective February 28, 1995.

Contract R&D and Other Issues

Although most taxpayers perform their R&D in-house, many contract out some or all of their R&D. Tax incentives are available not only for allowable in-house R&D expenditures but also for allowable expenditures in respect of R&D performed by other parties. In the fall of 1994, the Department of Finance held consultations to discuss contract R&D, third-party payments and the treatment of R&D funding. On the basis of these consultations, this budget proposes changes in the areas of:

- contract R&D and non-arm's length transactions;
- third-party payments; and
- unpaid amounts.

Contract R&D and Non-Arm's Length Transactions

R&D contracts may result in ITCs being earned on costs that would not be eligible for ITCs if the R&D was performed in-house. This circumstance is of particular concern in non-arm's length transactions because there may be greater flexibility in setting the contract amount. It is inappropriate for tax credits to be earned on profits and other non-allowable costs in contract R&D situations where the contracting parties are not dealing at arm's length.

Contract R&D

Taxpayers performing their own R&D ("in-house R&D") earn investment tax credits (ITCs) on allowable salaries, wages, materials, overheads and capital expenditures. Taxpayers who contract out their R&D earn ITCs on the R&D contract amount, to the extent that the R&D is performed in the taxation year. Taxpayers may also earn ITCs on third-party payments. The key differences between contract R&D and third-party payments are discussed later. The contract fee normally includes certain amounts that would not be eligible for the tax incentives if the R&D was performed in-house, for example, a profit element and certain costs such as building rent and interest.

To address the special circumstances of contract R&D, the budget proposes that, in situations where a taxpayer (payor) contracts out its R&D to a non-arm's length party (performer), the qualified expenditures on which ITCs are earned will be restricted to the allowable SR&ED expenditures incurred by the performer. In these situations, the payor's expenditures in respect of contract R&D will not be qualified expenditures for ITC purposes. The performer will, however, be able to transfer its qualified expenditures incurred in the year to the payor up to a maximum of the contract amount. This measure will apply to expenditures incurred by a payor in taxation years commencing after 1995. As a result, the payor's expenditures in respect of non-arm's length contract R&D will earn ITCs only to the extent of the qualifying expenditures transferred from the performer.

Illustration of the effect of the proposal

A wholly owned subsidiary performs contract R&D for its parent. This is the only R&D performed by the subsidiary. The contract fee is $1,000 and the subsidiary incurs qualifying expenditures of $800. Under the current rules the parent would earn an ITC of $200 ($1,000 @ 20 per cent) and the subsidiary would not earn an ITC. In addition to the ITC, the parent would have a subsection 37(1) deduction of $1,000. The parent's SR&ED expenditure pool is reduced by the ITC in the year after the credit is used to reduce taxes otherwise payable or refunded.

As a result of this proposal the subsidiary could transfer, to the payer, all or a portion of the $800 of qualifying expenditures. The maximum ITC that can be earned by both parties is $160 ($800 @ 20 per cent). Regardless of the amount of qualifying expenditures transferred for ITC purposes, the parent would continue to have a subsection 37(1) deduction of $1,000. The parent's and/or subsidiary's SR&ED expenditure pool is reduced by the ITC in the year after the credit is used to reduce taxes otherwise payable or refunded.

The budget also proposes to address a general concern about non-arm's length transactions by introducing rules so that, where an R&D performer purchases goods or services for SR&ED from a person with whom the performer does not deal at arm's length, the amount eligible for ITCs to the performer shall be limited to the costs to the non-arm's length person of providing the goods or services. This measure will apply to expenditures incurred in taxation years commencing after 1995.

In addition to the above changes, there will be new information requirements for all taxpayers claiming expenditures in respect of contract R&D. The T661 form will be revised to require taxpayers contracting out R&D to provide further information. This information will include the name of the performer, the amount of the contract expenditures and the performer's GST registration number. This requirement will only apply where the contract expenditures for the year in respect of the particular performer exceed $30,000.

Third-Party Payments

Contract R&D and third-party payments

Taxpayers can make payments to certain entities to be used for R&D. These payments are commonly referred to as "third-party payments". The key difference between third-party payments and contract R&D is the degree of control the payer has over the R&D being performed. In contract situations, the R&D services are performed directly for the payer who obtains the rights to the R&D. In third-party situations, the payer does not control the R&D performed, but obtains an entitlement to exploit the results of the R&D. Furthermore, unlike contract R&D, these payments generally become eligible for the SR&ED tax incentives at the time the payment is made rather than at the time that the R&D is performed.

Taxpayers claiming expenditures in respect of third-party payments are required to file prescribed information in accordance with Schedule A of form T661. However, there are currently no reporting requirements for entities that receive third-party payments. As a result, the government currently collects relatively little information on these payments and the resulting R&D.

Building on the consultations held last fall, discussions will be held with affected third parties to determine how further information can be provided on the nature of the R&D performed and the expenditures incurred. This additional information will enable the government to better monitor the SR&ED tax incentives in this area. As a first step toward collecting better information, the budget proposes that corporations exempt from tax under paragraph 149(1)(j) of the *Income Tax Act* be required to file, with their annual tax return, a T661 form to report their SR&ED work and expenditures. This measure will be effective for taxation years ending after February 27, 1995.

Generally, only non-taxable entities are eligible to receive third-party payments. However, under clause 37(1)(a)(ii)(D) of the *Income Tax Act*, "corporations resident in Canada" are also eligible to receive third-party payments. The budget proposes to treat third-party payments that rely on that clause in the same manner as contract R&D. Therefore, these payments will become eligible for the tax incentives only in the year in which the R&D is performed rather than at the time of payment. This measure will be effective for payments made after 1995.

Unpaid Amounts

Tax credits are normally earned in the year that the work is performed even if payment has not been rendered. Therefore, in some cases, tax credits may be earned on unpaid amounts. For tax credit purposes there is currently no restriction on how long these amounts may remain unpaid, except in the case of salaries and wages, which must be paid within 180 days of year end. The budget proposes to introduce rules similar to those for wages and salaries to require all other current expenditures incurred in a year to be paid within 180 days of the year end in order to be eligible for ITCs. For amounts that are not paid within this time frame, the expenditures will be deemed to have been incurred for tax credit purposes in the year the amount is paid. The measure will not apply where payment has been rendered within 90 days after the legislation implementing this proposal receives Royal Assent.

The Taxation of Family Trusts

Family trust arrangements allow property to be held by a trust for the benefit of beneficiaries under the trust. Trusts are used for many purposes, including succession planning for businesses and dealing with the needs of beneficiaries in special circumstances, such as age and disability. The budget proposes two changes to the taxation of family trusts to ensure that they do not provide any undue tax advantages.

21-Year Deemed Disposition Rule

The existing provisions relating to the taxation of trusts generally require trust assets to be treated for tax purposes as if they were disposed of every 21 years. This measure accompanied the introduction of capital gains taxation in 1972 to prevent trusts from being used to avoid the taxation of capital gains on death.

The previous government enacted a special election that permitted an extension of the 21-year rule and the postponement of capital gains taxation on trust property until the death of the last "exempt beneficiary" under the trust. An exempt beneficiary is essentially a family member no more than one generation removed from the person who established the trust.

Effective January 1, 1999, the budget proposes to eliminate this special election. Those trusts which have at any time before that date elected to postpone capital gains taxation will be subject to a

deemed realization of trust assets at fair market value on that date. This will not apply where all the trust property has been distributed to beneficiaries before that date. Where property is distributed from a trust to an exempt beneficiary, capital gains would be realized when the exempt beneficiary disposes of the property or when the exempt beneficiary (or the exempt beneficiary's spouse) dies.

Preferred Beneficiary Election

Before its allocation to beneficiaries, trust income is determined in the same manner as it is determined for other taxpayers. Interest, dividends and realized taxable capital gains are all included in computing a trust's income for this purpose. The taxable income of testamentary trusts (and certain pre-1972 trusts) is subject to the same graduated income tax rate structure as applies to individuals. The taxable income of other trusts is subject to income tax at the top personal income tax rate.

The preferred beneficiary election currently allows trust income to be allocated to "preferred" beneficiaries (defined to include the spouse, children and grandchildren of the settlor of the trust) and taxed in their hands rather than at the trust level. This allows trust income to accumulate, without the need to pay the income to beneficiaries. There is no requirement that the income allocated to a beneficiary ultimately be paid to that beneficiary.

The preferred beneficiary election is an exception to a general rule which provides that income earned on trust property is subject to tax in the hands of the trustee, except to the extent that such income is payable to, and consequently taxed in the hands of, the trust's beneficiaries.

The flexibility of the preferred beneficiary election and the potential to split income among large numbers of preferred beneficiaries make it a significant tax planning tool. The preferred beneficiary election allows trust income to be split among family members for income tax purposes without regard to the amount that the beneficiary will ultimately receive. Thus, for example, where trust income in the form of dividends is allocated to a beneficiary such as a young child with little other income, substantial amounts can be accumulated on a tax-free basis because of the dividend tax credit. In addition, the entitlement to the $500,000 lifetime capital gains exemption can be multiplied because of the preferred beneficiary election.

The budget proposes to eliminate the preferred beneficiary election, except as it applies to those beneficiaries who are entitled to a tax credit for mental or physical impairment or who would be so entitled if amounts paid for the remuneration of an attendant or for care in a nursing home were ignored. This measure will eliminate a tax planning technique and seeks to ensure a level playing field between a property held in a trust and property held directly.

This measure is to apply to taxation years of trusts that commence after 1995.

Re-Targeted Film Incentive

On December 1, 1994 the Ministers of Finance and National Revenue issued a press release announcing measures to improve the fairness of the tax system and prevent abuses through aggressive tax shelter promotions. Those measures:

- affect limited recourse financings;
- extend the base on which the alternative minimum tax is calculated;
- modify the rules relating to the identification of tax shelters; and
- expand the review and audits of tax shelters.

At that time the Minister of Finance also indicated that he shared concerns expressed by the Canadian film production industry about the efficiency of the existing capital cost allowance ("CCA") tax shelter incentive for Canadian certified productions and would be working closely with the Department of Canadian Heritage and industry associations in developing criteria for a replacement program.

The current CCA tax incentive for Canadian certified productions is designed to assist Canadian film producers to attract film financing from third-party investors. Only a portion of the cost of this incentive to the government results in a benefit to film producers, however, as the rest is shared between investors and financial intermediaries who put the tax shelter financing transactions together. The government believes that the existing incentive is not only an inefficient way to spend tax dollars but also, as a tax shelter mechanism, calls into question the fairness of the tax system.

The budget proposes to replace the existing CCA tax incentive for Canadian certified productions with a fully refundable tax credit ("Canadian film credit") for eligible films produced by qualified

taxable Canadian corporations. The new Canadian film credit will be available at a rate of 25 per cent of eligible salaries and wages expended after 1994 by a qualified corporation for the production of an eligible production owned by it, except where the financing of the film is eligible for transitional relief from the termination of the existing CCA film incentive (see below for information on this termination). For the purposes of this new credit, an eligible production is one that meets the existing definition of a Canadian certified production, subject to proposed modifications described below. Eligible salaries and wages qualifying for the new credit may not, however, exceed 48 per cent of the cost of an eligible production (as certified by the Minister of Canadian Heritage). The new credit will, therefore, provide assistance of up to 12 per cent of the cost of an eligible production.

Other government assistance received in respect of an eligible production will reduce the related expenditure base for this Canadian film credit in the same manner as is currently the case under the regular investment tax credit program. Similarly, the Canadian film credit will reduce the capital cost of the related film for the year following the year in which the credit arose.

Department of Finance officials are currently working closely with industry associations and the Department of Canadian Heritage in developing criteria for the replacement mechanism, the details of which will be released shortly. Matters under consideration include:

- the definition of eligible salaries and wages, and other terms, that will be relevant for computing the new credit;
- the development of Canadian ownership and other requirements for qualified production corporations, and for the commercial exploitation of such films in Canada by Canadian distributors or broadcasters;
- the authority of the Minister of Canadian Heritage to:
  - verify the accuracy of the cost of an eligible production, issue provisional certificates and ensure production control by Canadian producers; and
  - release information in respect of eligible productions to federal and provincial film agencies and the public; and
- the development of new eligibility requirements for Canadian certified productions that limit eligible productions to fiction, documentaries and music and variety programming – specifically

excluding news, commercials, industrials, corporate promotions, game shows, sexually or violently explicit productions, public affairs and information and live broadcasts.

In order to permit a smooth transition for the production of Canadian certified productions which generally require long lead times to produce, the existing CCA incentive will be retained for Canadian certified productions acquired before 1996 the principal photography of which is completed before March 1, 1996. The new credit may not be claimed in respect of a Canadian certified production any part of the cost of which is financed by flowing-out capital cost allowance or other deductions to investors. In other words, 1995 film productions may qualify for one or the other tax incentive regimes, but not both.

The elements of the existing film tax incentive to be eliminated for films acquired after 1995 (and films acquired in 1995 in respect of which the new credit is claimed) include the following:

- exemption of prescribed revenue guarantees from the limited partnership at-risk rules;
- exemption of Canadian certified productions from the leasing-property rules in Income Tax Regulation 1100(15);
- exemption of Canadian certified productions from the half-year CCA rule that generally applies to property in the year of its acquisition pursuant to Regulation 1100(2);
- eligibility of Canadian certified productions for an additional CCA (up to income from Canadian certified productions) in Income Tax Regulation 1100(1)(*l*); and
- exemption from the reduction of CCA in respect of certain revenue guarantees under Income Tax Regulation 1100(21).

Increases in Tax Rates

To help achieve the deficit reduction targets, the budget proposes to increase the rates of the large corporations tax (LCT) and the corporate surtax. In addition, the budget proposes that the tax on the capital of financial institutions (Part VI tax) be increased, on a temporary basis, for banks and other large deposit-taking institutions.

Large Corporations Tax (LCT)

The rate of the LCT will be increased from 0.2 per cent to 0.225 per cent.

The LCT, which was introduced in July 1989, is levied on the amount by which a corporation's taxable capital employed in Canada exceeds $10 million. It ensures that all large corporations contribute each year to reducing the federal deficit.

Corporate Surtax

The corporate surtax, currently levied at a rate of 3 per cent of the basic federal corporate income tax, will be increased to 4 per cent.

The surtax is calculated by reference to federal corporate tax payable after the 10-per-cent provincial abatement, but before tax credits such as the small business deduction and the manufacturing and processing deduction.

Both measures will apply for taxation years ending after February 27, 1995. For taxation years that include February 28, 1995, the additional LCT and surtax will be prorated on the basis of the number of days in the taxation year that are after February 27, 1995.

Interaction of LCT and surtax

An important feature of the corporate tax system is that the corporate surtax may be used to offset the LCT, so that large corporations, in effect, pay an amount equal to the greater of the two taxes. Where a corporation's surtax exceeds its LCT liability for the year, the excess surtax may be used to reduce LCT in the three preceding or seven subsequent taxation years. Where a corporation does not have any corporate surtax payable, it must pay the full amount of LCT. Taking this interaction into account, the LCT raises about $1 billion annually.

Temporary Capital Tax Increase for Large Deposit-Taking Institutions

This budget increases, on a temporary basis, the tax on the capital of banks and other large deposit-taking institutions. The temporary surcharge will be levied at a rate of 12 per cent of the financial institution capital tax imposed under Part VI of the *Income Tax Act* calculated before any credit for income taxes and as if there were a capital deduction of $400 million.

The surcharge will apply to financial institutions as defined under Part VI, but not to life insurance companies. Life insurance companies are already subject to an additional capital tax under Part VI. An investment allowance will be provided for investments in related financial institutions.

This surcharge will not be eligible to be offset by tax payable under Part I of the Act.

The surcharge will be in effect from February 28, 1995 until October 31, 1996. For taxation years that include February 28, 1995, the surcharge will be prorated on the basis of the number of days in the taxation year that are after February 27, 1995. Similarly, for taxation years that include October 31, 1996, the surcharge will be prorated on the basis of the number of days in the taxation year that are before November 1, 1996. Payment of the surcharge will be required to be reflected in monthly tax installments beginning in July of this year.

Tobacco Excise Tax

The National Action Plan on Smuggling announced on February 8, 1994, provided a comprehensive, integrated approach to confronting the very serious smuggling problem that was spreading across Canada. The elements of the plan included increased enforcement resources, reduced tobacco taxes, an excise tax on exported tobacco products and a health promotion surtax levied on the profits of tobacco manufacturers. Over the course of the last year, this plan caused a marked decline in contraband activity and a corresponding restoration of the domestic tobacco market to legitimate wholesalers and retailers.

The success of the government's anti-smuggling initiative, particularly in central Canada where the problem was most severe, allowed the government to announce a modest increase in tobacco taxes effective as of February 18, 1995. The increase amounted to $0.60 per carton of 200 cigarettes sold for consumption in Quebec and Ontario, the two provinces where federal-provincial tax reductions resulted in the lowest retail prices for tobacco products. The tobacco tax changes represent a first step toward the long-term restoration of uniform federal tax rates for tobacco products across Canada.

In conjunction with the federal tax increase, both Quebec and Ontario announced corresponding increases in their respective provincial tax rates applicable to tobacco products. This joint federal-provincial initiative is consistent with the matching tax reductions resulting from the National Action Plan on Smuggling and recognizes the importance of co-ordinated action to deal effectively with contraband activity. The government will also continue with the enhanced enforcement initiatives that were announced last February.

The government remains committed to reducing tobacco consumption among all Canadians. Toward this end, Health Canada will be proceeding with programs and initiatives under its Tobacco Demand Reduction Strategy, funded by the special surtax on tobacco manufacturers.

The increase in the federal excise tax rates for cigarettes became effective as of February 18, 1995, and is expected to generate additional revenues of $65 million in 1995-96 and subsequent fiscal years.

Gasoline Excise Tax

The budget proposes to increase the excise taxes on leaded and unleaded gasoline and aviation gasoline by 1.5 cents a litre, effective February 28, 1995, to raise an additional $500 million per year. The excise tax on diesel fuel will not be increased.

The excise tax on unleaded gasoline and unleaded aviation gasoline currently amounts to 8.5 cents per litre. Leaded gasoline and leaded aviation gasoline are taxed at the rate of 9.5 cents per litre. With the increases proposed, the new rates will be 10 cents per litre for unleaded and 11 cents per litre for leaded gasoline and aviation gasoline.

Other Measures

Air Transportation Tax

The air transportation tax is imposed on the amount paid by a person for air transportation. Proceeds from the tax are used to fund a portion of the cost of Transport Canada's air transport facilities and services.

As part of the government's efforts to meet its deficit targets, the budget proposes to recover a greater proportion of the cost of providing air transport services and facilities by increasing the air transportation tax on higher-priced domestic and transborder tickets and on other international tickets. Thus, the maximum tax on domestic and transborder air travel and the tax on international travel purchased in Canada will be increased from $50 to $55. The tax on international air transportation purchased outside Canada and the maximum tax on transborder air travel subject to the United States' 10-per-cent air transportation tax will be increased from $25 to $27.50.

These changes to the air transportation tax will raise $27 million in the 1995-96 fiscal year and $33 million in the 1996-97 fiscal year.

The new rates of tax will apply to tickets purchased on or after May 1, 1995. Where air transportation is purchased outside Canada and the tax is not prepaid, the new rates will apply to transportation which includes an international departure from Canada on or after May 1, 1995.

Other Excise Changes

The budget also proposes two amendments to improve the administration of the excise tax and duty systems.

Tobacco Product Markings

The *Excise Tax Act* will be amended to authorize the sale of Nova Scotia marked tobacco products in Prince Edward Island. The federal excise tax will apply to these products when sold in Prince Edward Island at the reduced rates currently applicable to unmarked tobacco products for sale in that province. This change, which will be effective on Royal Assent to the implementing legislation, is being made at the request of the governments of Nova Scotia and Prince Edward Island.

Seizure of Vehicles

Currently, the *Excise Act* requires that enforcement officers seize any vehicle used in the transportation of contraband alcohol and tobacco products, even where relatively minor amounts of contra-

band are found. The Act will be amended to provide enforcement officers with discretion with respect to the use of the power to seize vehicles. The Act will also be amended to require that notification of seizure be provided to persons with an ownership or other interest in a vehicle seized for an offense under the *Excise Act*.

Donations of Ecologically Sensitive Land

The income tax system currently provides substantial assistance for donations of ecologically sensitive land to charities and government bodies. Individuals receive a federal tax credit of 17 per cent on the first $200 donated and 29 per cent on any remaining portion of donations made in a year. Corporations claim a deduction from net income. Since the donation credit also affects surtaxes and provincial taxes, it can generate total tax savings of about 50 cents per dollar donated.

There is no limit on the amount that may be claimed for gifts to federal or provincial governments, while claims for gifts to charities and municipalities are limited to 20 per cent of an individual's (or corporation's) net income in a year. Donors are able to carry unused claims forward for up to five years, which in most cases ensures that they are able to claim the full value of their donations.

However, the value of donated land may often be high relative to the donor's income. As a result, the 20-per-cent rule may restrict the value of the donation credit, even after the five-year carry-forward is taken into account.

To further encourage the conservation and protection of Canada's environmental heritage, this budget proposes to exempt qualified donations of land, including qualified donations of covenants, servitudes and easements, from the annual limit of 20 per cent of net income.

In order to qualify for the exemption, donations must meet the following conditions:

- the donated land must be certified by the Minister of the Environment to be ecologically sensitive land, the conservation and protection of which is, in the opinion of the Minister, important to the preservation of Canada's environmental heritage; and
- the body to which the land is donated must be either a Canadian municipality or a registered charity that is designated by the Minister of the Environment at the time the donation is made to be

a body whose primary purpose is the conservation and protection of Canada's environmental heritage for the benefit of all Canadians.

As well, it is proposed that bodies that receive such gifts of land be required to ensure that the lands are not subsequently sold or their use changed without the permission of the Minister of the Environment. Where there is an unapproved disposition or change-in-use of such land, the organization will be subject to a penalty equal to 50 per cent of the value of the land at the time of the disposition or change-in-use.

The Minister of the Environment will consult with interested parties to develop the criteria to be applied for the certification of ecologically sensitive land and the designation of qualified recipients.

This proposal will apply to gifts of land, covenants, servitudes and easements made after budget day.

The estimated revenue cost of this measure is small.

Interest on Unpaid Taxes

To encourage the prompt payment of unpaid income taxes, the budget proposes that the rate of interest charged on late or deficient income tax payments be increased.

The level of income tax liabilities outstanding has grown over recent years, from $4.2 billion in 1988-89 to about $6.6 billion at the end of 1993-94. A significant portion of Revenue Canada's resources are devoted to collecting these liabilities. Given the fiscal challenges facing the federal government, it is important that, to the greatest extent possible, taxpayers pay their tax liabilities promptly.

The rate of interest currently charged on overdue taxes and paid on refunds during a calendar quarter is the average yield on the three-month Treasury bills sold in the first month of the preceding quarter, rounded up to the nearest percentage point, plus 2 percentage points.

Effective July 1, 1995, it is proposed that the rate currently charged on overdue taxes be increased by 2 percentage points. The new rate will apply to overdue income tax payments, insufficient income tax installment payments, unpaid employee source deductions and other amounts withheld at source, unpaid Canada Pension Plan contributions, unpaid unemployment insurance

premiums and unpaid penalties. The formula for calculating the rate of interest paid on refunds, as well as that for determining certain employment and other benefits, will remain unchanged.

The *Income Tax Act* permits the use of an interest offset (contra interest) in calculating interest payable on underpaid (deficient or late) installments. Taxpayers can reduce the interest they pay on an underpaid installment by overpaying other installments or paying them early. Interest is charged only to the extent that the interest on underpaid installments exceeds imputed interest on any overpayments. It is proposed that this contra interest system continue to apply the same rate to overpayments as to underpayments. In effect, this means that the new higher interest rate will be charged only on net deficient installments.

This measure will increase interest revenues by about $75 million in 1995-96 and $110 million in 1996-97.

Notice of Ways and Means Motion to amend the *Income Tax Act*, the *Canada Pension Plan* and the *Unemployment Insurance Act*

That is expedient to amend the *Income Tax Act* to provide among other things:

Pension and RRSP Limits

(1) That, for the purposes of applying the rules relating to registered pension plans, deferred profit sharing plans and registered retirement savings plans,

(a) the money purchase limit be changed to:

(i) $13,500 for 1996,

(ii) $14,500 for 1997,

(iii) $15,500 for 1998, and

(iv) for each year thereafter, $15,500 indexed by the growth in the average industrial wage in Canada, and

(b) the RRSP dollar limit be changed to:

(i) $13,500 for 1996, and

(ii) for each year thereafter, the money purchase limit for the immediately preceding year.

Retiring Allowances

(2) That, for the 1996 and subsequent taxation years, the limit under paragraph 60(*j*.1) of the Act on the amount that may be deducted in respect of the transfer of a retiring allowance to a registered retirement savings plan or a registered pension plan be calculated only with respect to service before 1996.

RRSP Overcontributions

(3) That, for the purpose of determining the amount of an individual's undeducted RRSP premiums to which the penalty tax under Part X.1 of the Act applies for a particular year after 1995, the $8,000 overcontribution tolerance be reduced to $2,000 plus a transitional amount for the year equal to the lesser of

(a) $6,000, and

(b) the tolerance, if any, that would be required for the year so that

(i) the sum of the tolerance and the amounts determined for the year for A and B in the formula in paragraph 204.2(1.1)(*b*) of the Act

is equal to

(ii) the amount of the individual's undeducted RRSP premiums immediately before February 27, 1995 that have not been deducted or withdrawn before the year (assuming, for this purpose, that premiums are deducted in the order in which they are paid) minus $2,000.

(4) That the amount of an individual's undeducted RRSP premiums to which the penalty tax under Part X.1 of the Act applies for 1996 and subsequent years be determined without taking into account the individual's net past service pension adjustment for the year.

(5) That, for the purpose of determining the amount of tax payable under Part X.1 of the Act for 1996 and subsequent years, an individual's qualifying RRSP premiums paid in the year in excess of a specified amount for the year be considered to have been paid in the following year rather than in the year, and, for the purpose of this paragraph,

(a) an individual's specified amount for a particular year is the amount by which

(i) the individual's RRSP deduction limit for the year (determined without subtracting the individual's net past service pension adjustment for the year)

exceeds

(ii) where the year is 1996, the amount of the individual's undeducted RRSP premiums at the beginning of the year minus the amount of those premiums on which tax is payable under Part X.1 of the Act in respect of December 1995, and

(iii) where the year is after 1996, the amount of the individual's qualifying RRSP premiums considered to be paid in the year rather than in the preceding year, and

(b) a qualifying RRSP premium of an individual is a premium paid to an RRSP on behalf of the individual where

(i) the premium is an amount to which the individual is entitled for services rendered (whether or not as an employee), and

(ii) the RRSP is part of an arrangement under which amounts to which two or more individuals are entitled for services rendered are paid directly to RRSPs on behalf of the individuals,

but does not include any part of the premium that, by making an election or exercising any other right under the arrangement after beginning to participate in it and within 12 months before the time the premium was paid, the individual could have prevented from being paid to an RRSP.

Fiscal Periods to End on December 31

(6) That each fiscal period that begins after 1994 of a business carried on in Canada by an individual, a professional corporation (which carries on the practice of an accountant, dentist, lawyer, medical doctor, veterinarian, or chiropractor) or a partnership of which a member is an individual, a professional corporation or a partnership referred to in this paragraph be deemed to end at the earlier of the time it would otherwise end and December 31.

Transitional Reserve

(7) That, where a taxpayer is required by reason of any measure giving effect to paragraph (6) to include in income for 1995 income from a business for two or more fiscal periods of the business, one of which includes December 31, 1994, and

(a) the taxpayer is an individual carrying on the business (other than as a member of a partnership) during a particular year ending after 1994 and before 2004, or

(b) the taxpayer is an individual or corporation that is a member of a partnership during a particular year ending after 1994 and before 2004 and the partnership carried on the business during the particular year,

the taxpayer be permitted to claim a reserve in computing income from the business for the particular year, not exceeding the least of:

(c) where the particular year is:

(i) 1995, 95%,

(ii) 1996, 85%,

(iii) 1997, 75%,

(iv) 1998, 65%,

(v) 1999, 55%,

(vi) 2000, 45%,

(vii) 2001, 35%,

(viii) 2002, 25%, and

(ix) 2003, 15%

of the taxpayer's income from the business for the fiscal period that ended on December 31, 1995,

(d) where the particular year is after 1995, the reserve claimed in the preceding taxation year by the taxpayer, and

(e) the taxpayer's income for the particular year.

Income Calculation for Transitional Reserve

(8) That, for the purpose of calculating a reserve under any measure giving effect to paragraph (7), the income from a business for the fiscal period ending December 31, 1995 be computed as if the maximum amount were deducted under the Act in respect of any other reserve, resource expenditure or any other discretionary deduction.

Extension of Return Filing Deadline

(9) That the date by which an individual (other than a trust) is required to file a return of income for the 1995 and subsequent taxation years be extended to June 15 of the following year where the individual carried on a business in the year (other than by reason only of the individual holding an interest in a limited partnership).

21-Year Rule for Trusts

(10) That

(a) the election that allows for the postponement of the day on which trust assets are considered by the 21-year rule to be disposed of not be available after 1998, and

(b) capital property, land inventory and resource property held on January 1, 1999 by a trust that has made that election be deemed to be disposed of by the trust on that day for proceeds equal to its fair market value.

Preferred Beneficiary Election

(11) That preferred beneficiary elections be eliminated for trusts' taxation years that begin after 1995, except with respect to beneficiaries entitled under subsection 118.3(1) of the Act to the tax credit for mental or physical impairment.

At-Risk Rules

(12) That the exemption from the limited partnership at-risk rules for revenue guarantees prescribed in respect of prescribed film productions for the purposes of subparagraph 96(2.2)(*d*)(ii) of the Act be eliminated for such guarantees granted after 1995.

Canadian Film Tax Credit

(13) That a refundable tax credit be provided to a qualifying corporation in respect of a certified production that is an eligible film or video tape produced and owned by the corporation equal to the lesser of

(a) 25% of qualified salaries and wages expended by it after 1994 in respect of the production, and

(b) 12% of the cost of the production,

as certified by the Minister of Canadian Heritage, except that no such credit be available in respect of a production any part of a cost relating to the production of which is deductible by a third-party investor.

Charitable Donations

(14) That the 20% limitation in respect of charitable donations be eliminated with respect to donations made after February 27, 1995 to Canadian municipalities and registered charities, designated by the Minister of the Environment, of land certified by the Minister to be important to the preservation of Canada's environmental heritage and that the municipality or charity be subject to a penalty of 50% of the fair market value of the donated land where the donated land is disposed of or its use is changed without the permission of the Minister.

Scientific Research and Experimental Development

(15) That work performed after February 27, 1995 in respect of information technology (including the use of software, hardware and communication technology to collect, process, store and disseminate information) carried on by or on behalf of a registered securities dealer or a "restricted financial institution" not qualify as scientific research and experimental development for the purposes of the Act.

Non-Arm's Length Contract

(16) That where a taxpayer incurs in a taxation year that begins after 1995 an expenditure in respect of scientific research and experimental development carried out on its behalf by a person who does not deal at arm's length with the taxpayer

(a) the expenditure not constitute a "contract payment" or a "qualified expenditure" for the purposes of the investment tax credit, and

(b) an amount of qualified expenditures incurred by the person in respect of scientific research and experimental development be transferred to the taxpayer at the end of the person's taxation year in which the qualified expenditure is incurred where

(i) the amount does not exceed the amount of the expenditure to which subparagraph (*a*) applies, and

(ii) the taxpayer and the person jointly so elect.

Non-Arm's Length Costs

(17) That an expenditure incurred by a taxpayer in a taxation year that begins after 1995 in respect of scientific research and experimental development not include, for the purposes of the investment tax credit, any amount in respect of costs for goods or services provided by a person who does not deal at arm's length with the taxpayer to the extent that those costs exceed the costs to the person of providing those goods or services.

Unpaid Amounts

(18) That an expenditure of a current nature incurred by a taxpayer in a taxation year (other than a taxation year that is not open to reassessment) in respect of scientific research and experimental development that would otherwise be a "qualified expenditure" and that has not been paid by the taxpayer within 180 days after the end of the taxation year be considered for the purposes of the investment tax credit to have been incurred only in the taxation year in which it is paid, unless the expenditure is paid within 90 days after Royal Assent to any measure giving effect to this paragraph.

Third-Party Payments

(19) That payments to which clause 37(1)(*a*)(ii)(D) of the Act applies made after 1995 by a taxpayer to a corporation resident in Canada be eligible for inclusion under subsection 37(1) of the Act, and be eligible for inclusion as a "qualified expenditure" for the purposes of the investment tax credit, only in the taxation year of the taxpayer in which the payment was used by the corporation in the carrying out of scientific research and experimental development in Canada.

Corporate Surtax

(20) That the rate of corporate surtax payable under section 123.2 of the Act be increased to 4% from 3% for taxation years that end after February 27, 1995, with the increase prorated for such taxation years that begin before February 28, 1995.

Investment Income of Corporations

(21) That an additional tax of 6 2/3% be imposed on the investment income (other than tax-exempt dividends) of Canadian-controlled private corporations for taxation years that end after June 1995 and that

(a) the tax be prorated for such taxation years that begin before July 1995,

(b) the tax be added to the corporation's refundable dividend tax on hand (RDTOH),

(c) the rate of tax payable under Part IV of the Act be increased to 33⅓% from 25% on taxable dividends received after June 1995, and

(d) the dividend refund rate for all RDTOH be increased to $1 for every $3 of taxable dividends paid after June 1995.

Tax on Large Corporations

(22) That the rate of tax on large corporations payable under Part I.3 of the Act be increased to .225% from .2% for taxation years that end after February 27, 1995, with the increase prorated for such taxation years that begin before February 28, 1995.

Part VI Surtax

(23) That, for taxation years that end after February 27, 1995 and begin before November 1, 1996, every corporation (other than a life insurer) that is a financial institution for the purposes of Part VI of the Act be subject to a surtax equal to 12% of its tax payable under Part VI for the year (determined without reference to the Part I tax credit and as if the capital deduction were $400 million) and that the surtax be prorated for taxation years that straddle either of those dates.

Contra Interest

(24) That, notwithstanding the proposed increased rate of interest payable on deficient tax payments described in the Budget Papers, the rate of interest applying under the contra-interest rule in subsection 161(2.2) of the Act in respect of instalment overpayments for any period after June 1995 continue to be the same as the rate applying to deficient instalments for that period.

Access to Third-Party Information

(25) That, after Royal Assent to any measure giving effect to this paragraph, the condition in subsection 231.2(3) of the Act under which judicial authorization may be granted to require information or documents to be provided to the Minister of National Revenue in respect of unnamed persons or groups of unnamed persons be limited to satisfying a judge that:

(a) the person or group is ascertainable, and

(b) the requirement is made to verify compliance by the person or persons in the group with any duty or obligation under the Act.

Trustees' Liability for Source Deductions

(26) That the rules governing the joint and several liability of trustees, and similar persons who have substantial control over the affairs of another person, to deduct and remit tax ("source deductions") where they authorize or cause remuneration to be paid or similar payments to be made on behalf of the other person, be amended with respect to such payments made after Royal Assent to any measure giving effect to this paragraph

(a) to extend the class of persons to whom the joint and several liability applies to include interim receivers, secured creditors and agents of persons in that class,

(b) to clarify that those persons need not be acting in a fiduciary capacity for the joint and several liability to apply, and

(c) to extend the application of the rules to source deductions in respect of patronage dividends and payments to non-resident persons.

Interference With Source Deductions

(27) That certain secured creditors who have influence over the issuance or clearance of a taxpayer's remittances to the Receiver General of source deductions and who interfere after Royal Assent to any measure giving effect to this paragraph with those remittances be jointly and severally liable with the taxpayer to pay to the Receiver General those source deductions and any applicable interest and penalties.

Old Age Security Benefits

(28) That the provisions relating to the recovery of the benefits under the *Old Age Security Act* be altered for the 1996 and subsequent taxation years in accordance with the proposals described in the Budget Papers.

Canada Pension Plan and *Unemployment Insurance Act* Amendments

And that it is expedient to amend the *Canada Pension Plan* and the *Unemployment Insurance Act* to provide changes to the provisions thereof relating to access to third-party information, instalment interest and the liability for source deductions in accordance with the changes proposed to the corresponding provisions of the *Income Tax Act*.

Notice of Ways and Means Motion to amend the *Excise Tax Act* (1)

That it is expedient to amend the *Excise Tax Act* to provide among other things:

Air Transportation Tax

(1) That the maximum amount of the air transportation tax imposed on an amount paid or payable in Canada for the transportation of a person by air that begins in the taxation area and ends outside the taxation area be increased to $55.

(2) That the maximum amount of the air transportation tax imposed on an amount paid or payable outside Canada for the transportation of a person by air that begins in the taxation area and ends outside the taxation area be increased to

(a) $55 where the first emplanement of the person occurs at an airport in Canada, and

(b) $27.50 in any other case.

(3) That any enactment founded on paragraphs (1) and (2) of this motion apply in respect of

(a) an amount paid or payable in Canada on or after May 1, 1995 for the transportation of a person by air on or after that date, and

(b) an amount paid or payable outside Canada for the transportation of a person by air which includes an emplanement in Canada on or after May 1, 1995 on a specific flight having as a destination an airport outside Canada and subsequent deplanement by the person from the flight at an airport outside Canada, except where the tax in respect of such transportation has been paid to a licensed air carrier or the carrier's agent before that date.

Excise Tax on Gasoline

(4) That the excise tax on unleaded gasoline, leaded gasoline, unleaded aviation gasoline and leaded aviation gasoline be increased by 1.5 cents per litre effective February 28, 1995.

PEI Tobacco Product Markings

(5) That the Act be modified to authorize the sale in Prince Edward Island of manufactured tobacco that is marked or stamped, in accordance with a statute of Nova Scotia, for retail sale in Nova Scotia, and to phase out the sale in Prince Edward Island of black stock.

Notice of Ways and Means Motion to amend the *Excise Tax Act* (2)

That it is expedient to amend the *Excise Tax Act* to provide among other things:

Extension of Filing Deadline

(1) That, after 1994, where the reporting period of a registrant who is an individual is a fiscal year that ends on December 31 and the due date of the return of income that the registrant is required under Part I of the *Income Tax Act* to file for the year (or would be so required if the registrant had tax payable under that Part for the year) is June 15 of the following year,

(a) the return for the reporting period of the registrant be required to be filed on or before June 15 of that following year, and

(b) the net tax for the reporting period of the registrant be required to be remitted on or before April 30 of that following year.

Interference with Remittances

(2) That certain secured creditors of a registrant who have influence over the clearance or issuance of payments of net tax owing by the registrant and who interfere, after Royal Assent to any measure giving effect to this paragraph, with the registrant's remittance to the Receiver General of amounts payable under Part IX of the Act be jointly and severally liable with that registrant to pay to the Receiver General those amounts and any applicable interest and penalties.

Notice of Ways and Means Motion to amend the *Excise Act*

That it is expedient to amend the *Excise Act* to provide among other things:

Discretion to Seize Goods

(1) That subsection 88(2) of the Act relating to the mandatory seizure of goods used in contravention of the Act, including vehicles used to transport contraband alcohol and tobacco products, be amended to provide discretion to officers in their exercise of the power to seize goods.

Notification of Seizure

(2) That where an officer has evidence that a person may be entitled to an order under the Act declaring that his or her ownership or related interest in a seized vehicle or other good is not affected by its seizure, the officer be required to make all reasonable efforts to ensure that notification of the seizure is sent to the person at the person's last known address.

Applicability of Section 164

(3) That the Act be amended to clarify that section 164 applies in respect of all goods subject to excise.